

MAPFRE
Middlesea p.l.c.

Executive Summary:

We are initiating our coverage on MAPFRE Middlesea plc (“MMS” or “the Company”), with a Hold recommendation and a 1-year price target of €2.11.

The Group’s gross premiums written from the general business has experienced a CAGR of 19% during the last four years and we expect this to continue, albeit at a slower rate, in line with a projected slow down growth of the local economy. Despite an increase in road accidents and extreme events experienced in Malta, MMS’s combined ratio stood at 93% in FY 2018. We expect the Group to maintain this profitability level (MMS’s long-term target is of 96%).

In the last four years, MMS’s gross premiums written from the long term business increased by 20% CAGR. Despite a reported drop of 6.9% in the gross premium written as at the interim financials of June 2019, we expect the demand for the Group’s investment services to remain resilient, in lieu of Malta’s high savings ratio, according to management.

MMS is currently trading at P/B multiple of 2.2x. This is on the high side when compared to other European peers such as Allianz SE (P/B: 1.3x) and Zurich Insurance Group AG (P/B: 1.9x), however in our opinion, this is sustained by the Group’s higher SCR coverage ratio of 270.4%, with peers Allianz SE and Zurich Insurance Group AG standing at 229% and 216%, respectively.

The strong solvency ratio should enable the Group to maintain a high level of dividend distribution, where in the last two years this exceeded the level of profitability. Nevertheless, we remain cautious that a dividend payout ratio equal to or exceeding the 100% is not sustainable in the long-term. Consequently, we expect MMS shares to trade at a lower P/B multiple in line with European peers, once the Group’s SCR coverage ratio decreases to the level of its peers. Upon taking the above factors into consideration, we rate the shares a Hold.

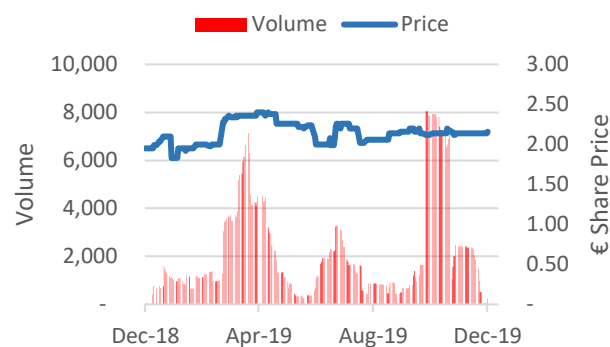
Company Overview:

MAPFRE Middlesea plc is the parent company of the MAPFRE Middlesea Group, which is the largest insurance group in Malta. The Group operates in the insurance sector and conducts business in both the life and non-life market. The Group’s general business comprise all of the non-life classes including Motor, Home, Health, Marine, and General Liability. The long term business comprise of both life insurance and investment services, and is carried out through MAPFRE MSV Life plc, which is a 50/50 joint venture with Bank of Valetta plc.

Stock Rating
Price target (1Yr)
Hold
€2.11

Country	Malta
Industry	Financial Services / Insurance
Ticker Symbol	MMS
Price (as at 23/12/2019)	€2.16
Price Target (1-Year)	€2.11
Upside / Downside to PT	-2.3%
12m cash div. (Forecast)	€0.10
12m Total S’holder Return	2.4%
Market Cap	€198.7 million
Shares Outstanding	92.0 million
Free Float	14.4%
Net Dividend Yield *	4.5%
Current P/E *	21.7x
Forward P/E **	21.1x
* Based on the last twelve months (LTM) as of 30 Jun 2019	
** CC estimates	

Exchange	Malta Stock Exchange (MSE)
52-week range	€1.83 - €2.40

Price and Volume Movement (20 day moving average)


Source: Bloomberg

Market Research


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The major shareholders of the Group are MAPFRE Internacional S.A. and Bank of Valetta plc with 54.6% and 31.1% shareholding, respectively. MAPFRE is a major player in the global insurance market with interests spread across five continents, and one of the fastest growing insurance groups in Spain and South America.

Company Update:

Dividends - The Board of directors of MMS paid a net dividend of €0.098 per share based on FY 2018 (FY 2017: €0.105), equivalent to a net total dividend of €9.0 million (FY 2017: €9.7 million). In line with the Group policy, the Board did not declare a dividend based on June 2019 interim financials, and will determine the extent of dividend distribution for 2019 based on the full year results of FY 2019.

SWOT Analysis

Strengths

- ✓ Largest insurance group in Malta, with synergies from MAPFRE international and the largest local bank, Bank of Valletta plc
- ✓ Strong Solvency Capital Requirement (SCR) Coverage of 270.4% as at FY 2018
- ✓ A proven track record in terms of dividend distribution
- ✓ Management improved the profitability of the general business, with a current combined ratio of 93% (FY 2018) from the loss making position recorded in FY 2016 of 102%
- ✓ A strong distribution system across the Maltese Islands via a network of agents and intermediaries
- ✓ Diversified range of insurance products and investment services, including both the life and non-life market
- ✓ MMS currently has no financial debt and this will prove to be beneficial for the Group to manage its insolvency ratios

Opportunities

- As the Group continues to grow, the ability to decrease fixed costs over a growing customer base
- MMS should benefit from Malta's high savings ratio, where strong demand should remain for capital guaranteed investments, like the Single Premium Plan.
- Increased government support towards private investment plans, such as the private pension scheme

Weaknesses

- ✗ Highly exposed to the Maltese economy
- ✗ Regulatory burden is continuously increasing and is harming profitability
- ✗ Dividend distribution for the last 2 years exceeded the profitability level, although this may be sustainable in the short-term due to strong SCR Coverage, it is not sustainable in the long-term
- ✗ The Group has a low level of shares currently floated (9.4% of issued shares), which has a negative impact on liquidity.

Threats

- ! Increased incidence of fraudulent activity
- ! A disastrous event and corresponding claims can severely impact the Group's insurance business
- ! Increased local competition in both the life and non-life market
- ! Implementation of the new IFRS 17 (effective from FY 2021) is a strenuous and costly exercise, with potential material changes to insurer's financial position
- ! Lack of available skilled workforce
- ! A looming global recession or prolonged subdued economic growth

Investment Stance

We are initiating our coverage on MAPFRE Middlesea plc (“MMS” or “the Company”), with a Hold recommendation and a 1-year price target of €2.11. MMS is well positioned in the local insurance industry and provides a diversified insurance product range and investment services.

The Group’s gross premiums written from the general business (non-life market) has experienced a compounded annual growth (CAGR) of 19% during the last four years and we expect this to continue, albeit at a slower rate, in line with a projected slow down growth of the local economy. In recent years, Malta experienced an increase in road accidents (Q1 2019 up by 8.4% on comparative basis with Q1 2018¹) and severe storms, despite this the combined ratio of MMS general business stood at 93% in FY 2018. We expect the Group to maintain its profitability and for it to remain in line with management’s long-term target of 96% (a combined ratio of less than 100% indicates a profitable activity).

In the last four years, MMS’s gross premiums written from the long term business (life market) increased by 20% CAGR. This is mainly attributable to the Single Premium Plan, which remains the largest driver of the Group’s profitability. Despite a reported drop of 6.9% in the long term gross premium written as at the interim financials of June 2019, we expect the demand for the Group’s investment services to remain resilient, in lieu of Malta’s high savings ratio, according to management.

MMS is currently trading at a book value per share of €1.00 based on FY 2018 and at a price to book (P/B) multiple of 2.2x. The P/B multiple of MMS is on the high side when compared to other European peers such as Allianz SE (P/B: 1.3x) and Zurich Insurance Group AG (P/B: 1.9x), however in our opinion, this is sustained by the Group’s higher SCR coverage ratio of 270.4%, with peers Allianz SE and Zurich Insurance Group AG standing at 229% and 216%, respectively.

The strong solvency ratio should enable the Group to maintain a high level of dividend distribution, where in the last two years this exceeded the level of profitability. MMS is currently trading at a net dividend yield of 4.5% and at an anticipated forward net dividend yield of 4.7%. Nevertheless, we remain cautious that a dividend payout ratio equal to or exceeding the 100% is not sustainable in the long-term. Consequently, we expect MMS shares to trade at a lower P/B multiple in line with European peers, once the Group’s SCR coverage ratio decreases to the level of its peers.

Upon taking the above factors into consideration, coupled with the Group’s ability to sustain a high dividend payout ratio in the foreseeable future, we rate the shares a Hold.

¹ National Statistics Office – News Release 081/2019

Valuation

Our 1-year price target is €2.11. This is calculated using a Price to Book model with a P/B multiple of 2.0x, with a cost of equity of 7.9%.

MMS Financials - €'000s (unless otherwise indicated)	FY2017	FY2018	LTM2019 ²	FY2019F ³	FY2020P
	€	€	€	€	€
Balance on general business	5,787	4,988	6,166	6,331	5,798
Balance on long term business	12,829	14,748	14,537	15,297	16,228
Total Income from insurance activities	18,616	19,736	20,703	21,629	22,026
Other Investment income less investment expenses and charges	2,332	1,643	1,591	3,279	2,886
Investment return transferred to general business	(1,925)	(1,228)	(1,139)	(2,315)	(2,126)
Other income	1,497	1,420	1,363	1,500	1,500
Administrative expenses	(2,811)	(3,015)	(3,148)	(3,166)	(3,229)
Profit before tax	17,709	18,556	19,370	20,927	21,056
Tax Expense	(4,188)	(4,521)	(4,741)	(5,232)	(6,317)
Profit for the year	13,521	14,035	14,629	15,696	14,739
- Shareholders	8,510	8,594	9,140	9,417	8,844
- Non-controlling interests	5,011	5,441	5,489	6,278	5,896
Increase in value in-force business	2,416	253	7,475	8,348	-
Other comprehensive income	(155)	(235)	(70)	60	-
Total comprehensive income for the year	15,782	14,053	22,034	24,104	14,739
- Shareholders	9,563	8,485	12,807	14,462	8,844
- Non-controlling interests	6,219	5,568	9,227	9,641	5,896
Earnings Per Share – in (€)	0.093	0.093	0.099	0.102	0.096

Equity Evaluation	FY2017	FY2018	LTM2019	FY2019F	FY2020P
Equity excluding non-controlling interests - €'000s	92,876	91,673	83,024	97,135	96,561
Book value per share - €	1.01	1.00	0.90	1.06	1.05
P/B Multiple	n/a	2.2x	2.4x	2.0x	2.0x
P/E Multiple	n/a	23.1x	21.7x	21.1x	22.5x
Dividend Yield	n/a	4.5%	4.5%	4.7%	4.5%
Earnings Yield	n/a	4.3%	4.6%	4.7%	4.5%

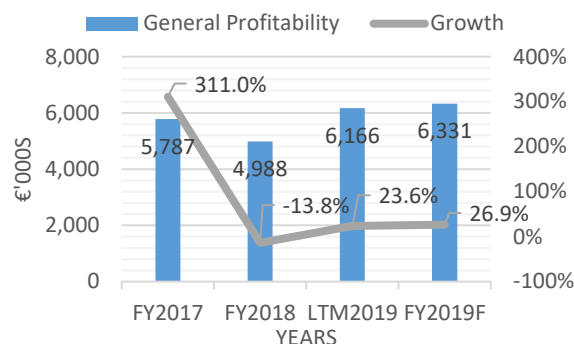
Source: Audited Financial Statements and CC Estimates

² LTM 2019 is calculated by adding the interim results (H1) of 2019 with the audited results of financial year 2018, less H1 2018.

³ Our forecasted figures do not take into account the implications brought about by the adoption of IFRS 16, where most leases have been capitalised as from 1 January 2019.

Investment Thesis Variables

- General Business** - The non-life sector of the Group mainly consists of Motor, Home, Health, and General Liability. In FY 2018, MMS's main growth in gross premiums written was recorded in the accident and health segment with a growth of 23.2%, followed by general liability with a growth of 12.2%. Overall gross premiums written increased by 11.4% in FY 2018. We assumed an overall growth rate of 7% in the gross premiums written for FY 2019 and FY 2020.



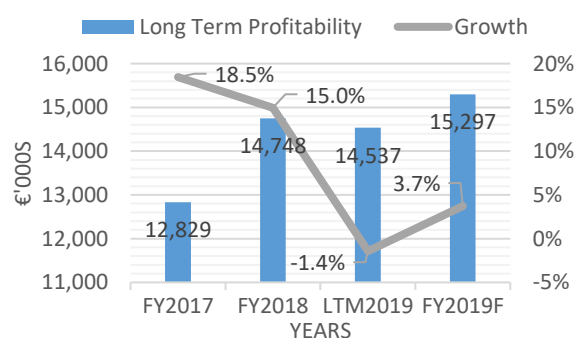
Source: Financial Statements / CC Workings

Outward reinsurance premium represents the premiums passed on to other insurance companies (reinsurers), while the change in the unearned premiums provision represents the movement in the balance of premiums which cover a period in excess of the financial period (January to December). Based on a historical trend, these two factors in our valuation were assumed at 20% of the gross premiums written.

An important metric in analysing the non-life market is the Combined ratio, which aggregates the Expenses/Net Premium Earned ratio and the Loss/Net Premium Earned ratio. The Group's general business combined ratio stood at a healthy level of 92.9% in FY 2018 (FY2017: 92.3%). We are predicating the combined ratio to remain profitability at the 93% level in FY 2019 and to deteriorate slightly to 94% in FY 2020, in line with MMS's management long-term target of 96%.

In light of the above factors we are predicting the profitability generated from the general business to increase to €6.3 million in FY 2019 from €5.0 million in FY 2018, an increase of 26.9%, and to subsequently decrease to €5.8 million in FY 2020.

Long Term Business - The life sector of the Group primarily consists of investment services and life insurance. The investment services represents the bulk of profitability, contributing to circa 90% of the total gross premiums written. During the period 2014 to 2018, net insurance premiums written increased by a CAGR of 0.7%. We are predicting this to remain stable and assumed a 1% growth in FY 2019 and FY 2020. Insurance contracts claims stood at 105.8% of the net insurance premiums in FY 2018 (FY2017: 101.1%). In our valuation period we assumed insurance claims to remain at these levels, and accordingly we utilised a 105% ratio.



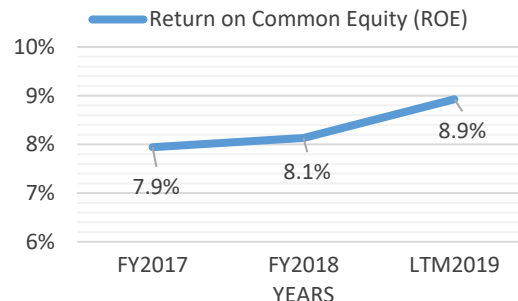
Source: Financial Statements / CC Workings

The bulk of investment premiums is attributable to the Single Premium Plan and the Group experienced a rapid CAGR of 24.5% during the last four years. Nonetheless, during H1 2019 long term gross premium written registered a drop of 6.9% when compared to H1 2018. Despite this, the profitability from the long term business decreased relatively lower by 2.7%, which we assume is linked to a better market performance when comparing 2019 with 2018.

Based on the performance of H1 2019, we anticipate investment premiums to decrease by 6.5% in FY 2019 on annual basis and to recover to 5% growth in FY 2020. The contribution from investment premiums (less claims)

net of the income from investments stood at €35.1 million in FY 2018. Based on our valuation model we are predicting the net contribution from investment premiums net of the income from investments to be at €34.3 million and €36.1 million in FY 2019 and FY 2020, respectively.

- Investment Return** - The investment income has declined from a return of 8.3% in FY 2014 to negative 2.1% in FY 2018, mainly attributable to a deteriorating global market return. Albeit, 2019 has been a strong year for the financial markets and consequently, we are predicting a return of 8% for FY 2019. Based on the possibility of a global recession or prolonged subdued economic growth, we are forecasting the investment income return to decrease to 3% in FY 2020.
- Administrative Expenses** - The non-technical account includes administrative expenses that are not linked to the insurance business (technical accounts) and based on historical figures these amounted to circa €3.0 million annually. We are anticipating administrative expenses to remain fairly stable, albeit increasing to €3.2 million in FY 2019 and FY 2020.
- Other Comprehensive Income (OCI)** - The OCI mainly consists of the movement in the value of in-fore business, which is classified as an intangible asset. The value of in-fore business is generally associated with life insurance and it represents the present value of the future earnings that the insurance company will realise from a pool of life insurance policies less the present value cost of holding capital to support these policies. This computation incorporates both future economic and demographic factors and consequently it is inherently difficult to forecast. In our valuation model, the value of in-fore business for FY 2019 was based on the H1 2019 results and given the subjective nature of this line item we assumed the OCI to be nil in FY 2020.
- Net Income and Earnings per share (EPS)** - We are forecasting net income to increase to €15.7 million in FY 2019 compared to €14.6 million in LTM 2019. This translates to an EPS of €0.102 for FY 2019, compared to an EPS of €0.099 for LTM 2019. The Return on Common Equity (ROE) stood at 7.9% in FY 2017 and improved to 8.1% in FY 2018. The improved profitability of €14.6 million achieved in the LTM 2019, an improvement of €0.6 million over FY 2018, resulted in the ROE to increase to 8.9% in the LTM 2019.
- Dividends** - The Group has for the last five years distributed a dividend, with a significant increase in dividends distributed during the last two years, where in FY 2018 the net dividend payout ratio was 104.7% (FY 2017: 114.0%). We remain cautious that a dividend payout ratio equal to or exceeding the 100% is not sustainable in the long-term, nevertheless given the Group's strong solvency ratio of 270.4%, we anticipate that MMS can distribute 100% of the projected profits of FY 2019 and FY 2020. This translates to a forward net dividend yield of 4.7% based on FY 2019 forecasts.



Source: Financial Statements / CC Workings

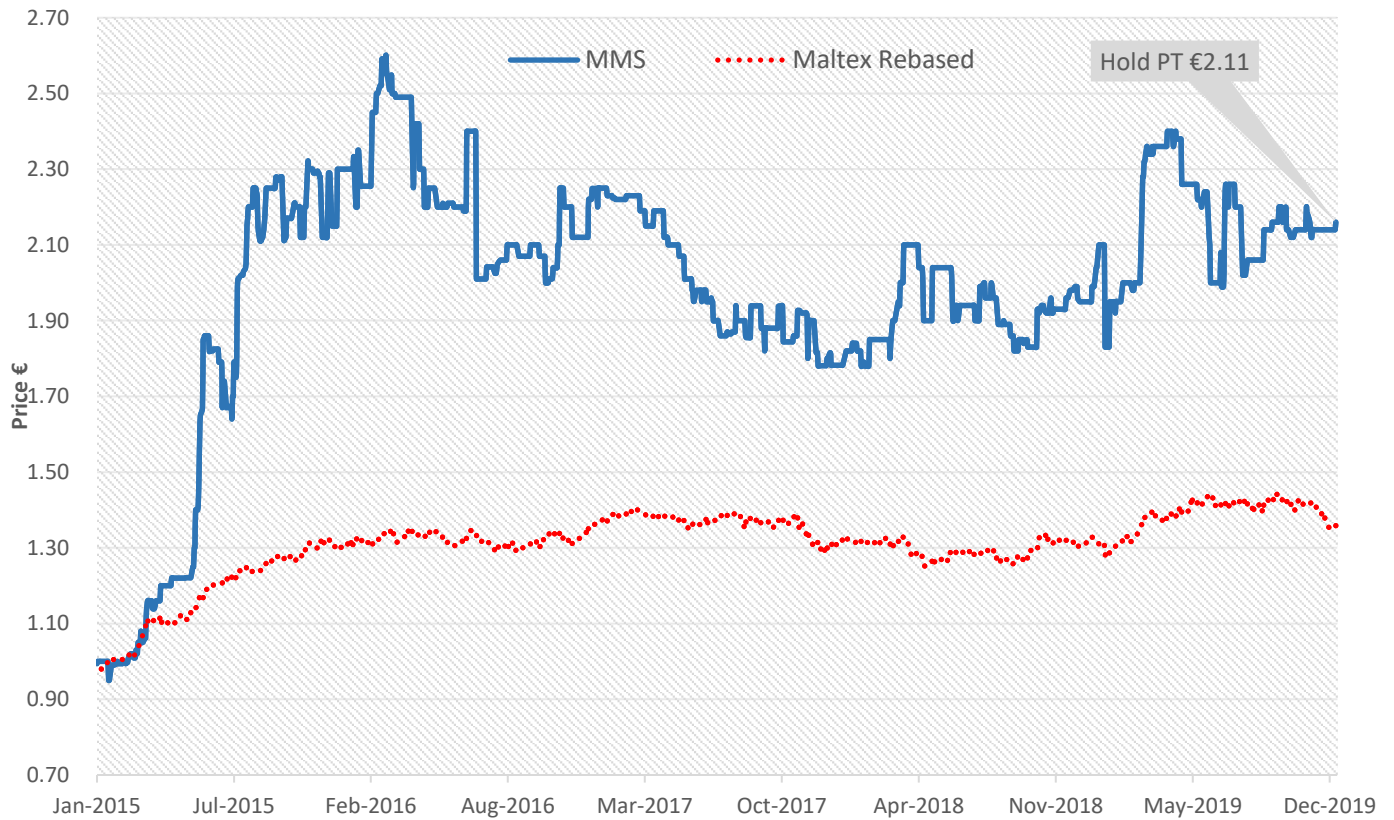
Key Financial Indicators

MMS plc - €'000's (unless otherwise stated)	Dec-17	Dec-18	LTM 2019
Technical Account - General Business			
Net premiums written	50,388	55,169	n/a
Change in the provision for unearned premiums	(255)	(2,191)	n/a
Allocated investment return transferred from non-technical account	1,925	1,228	n/a
Total technical charges	(46,271)	(49,218)	n/a
Balance on the general technical account	5,787	4,988	n/a
Net premiums written growth	5.8%	9.5%	n/a
Net loss ratio (claims incurred / net premiums earned)	62.0%	61.7%	n/a
Expense ratio (net operating expense / net premiums earned)	30.3%	31.2%	n/a
Combined ratio (net loss ratio + expense ratio)	92.3%	92.9%	n/a
Technical Account - Long-Term Business			
Net earned premiums	287,289	318,550	n/a
Income from investments and other technical income	66,482	(45,187)	n/a
Total technical charges	(340,942)	(258,615)	n/a
Balance on the long-term technical account	12,829	14,748	n/a
Net earned premiums growth	5.8%	10.9%	n/a
Non-Technical Account			
Total other income	1,904	1,835	1,815
Administrative expenses	(2,811)	(3,015)	(3,148)
Net income	13,521	14,035	14,629
Earnings per share (EPS) - €	0.515	0.038	0.042
Growth in EPS (YoY)	83.8%	1.0%	6.4%
Dividend per share (DPS) - €	0.105	0.098	0.098
Growth in dividends (YoY)	175.6%	-7.2%	0.0%
Sustainable growth rate in dividends	-1.1%	-0.4%	0.1%
Balance Sheet			
Cash and Cash Equivalents	64,580	70,387	93,549
Total Assets	2,214,752	2,318,779	2,532,102
Total Liabilities	2,041,272	2,147,085	2,376,055
Total Equity	173,480	171,694	156,047
Shares Outstanding	92,000	92,000	92,000
Cash Flow			
Cash Flow from Operating Activities (CFO)	167,980	200,473	168,869
Cash Flow from Investing Activities	(164,127)	(178,827)	(99,607)
Free Cash Flow (FCF)	3,853	21,646	69,262
Cash Flow from Financing Activities	(9,288)	(15,839)	(30,634)
Ratios			
Profitability			
Return on Common Equity (Net Income / Common Equity)	7.9%	8.1%	8.9%
Return on Assets (Net Income / Total Assets)	0.6%	0.6%	0.6%
Solvency			
Solvency coverage ratio	288.1%	270.4%	n/a
Gearing Ratio (Total Liabilities / Total Assets)	92.2%	92.6%	93.8%
Dividend payout	114.0%	104.7%	98.5%

Source: Audited Financial Statements / Interim Results and CC Workings

Historical 1-Year Price Target

Reference	Date	Price	Price Target	Analyst	Recommendation
MMS	27.12.2019	€2.16	€2.11	Rowen Bonello	Hold



Source: Bloomberg

Glossary and Definitions

Income Statement	
Net premiums written	Net premiums written is the sum of premiums written by an insurance company over the course of a period of time, less premiums ceded to reinsurance companies, plus any reinsurance assumed.
Change in the provision for unearned premiums	Unearned premium is the premium corresponding to the time period remaining on an insurance policy.
Net Income	The profit made by the Group/Company during the financial year net of any income taxes incurred.
Net loss ratio	The net loss ratio represents the ratio of losses to premiums earned.
Expense ratio	The expense ratio represents the ratio of expenses to premiums earned.
Combined ratio	The combined ratio is a measure of insurance profitability, calculated by aggregating the net loss ratio and the expense ratio.
Profitability Ratios	
Return on common equity	Return on common equity (ROE) measures the rate of return on the shareholders' equity of the owners of issued share capital, computed by dividing the net income by the average common equity (average equity of two years financial performance).
Return on assets	Return on assets (ROA) is computed by dividing net income by total assets.
Earnings per share (EPS)	Earnings per share (EPS) is the amount of earnings per outstanding share of a Group's/Company's share capital. It is computed by dividing net income by total shares outstanding as at the statement of financial position date.
Dividends Ratios	
Dividend per share	Dividend per Share is the amount of dividends per outstanding share of a Group's/Company's share capital. It is computed by dividing net dividends by total shares outstanding as at the statement of financial position date.
Sustainable growth rate in dividends	This ratio indicates the sustainable growth rate of dividends given the profitability of the Group/Company and the respective level of dividends distribution.
Dividends yield as at year-end	This ratio indicates how much a Group/Company pays out in dividends each fiscal year relative to its share price. It is computed by the dividing the Dividend per Share by the share price as at year-end.
Cash Flow Statement	
Free cash flows (FCF)	The amount of cash the Group/Company has after it has met its financial obligations. It is calculated by taking Cash Flow from Operating Activities less the cash flow used in investing activities of the same financial year.
Balance Sheet	
Shares outstanding	Outstanding shares refer to the Group/Company stock currently held by all its shareholders.
Financial Strength / Capital Adequacy Ratios	
Solvency capital requirement (SCR)	The solvency capital requirement is the amount of funds that insurance and reinsurance companies in the European Union are required to hold.
Solvency coverage ratio	The solvency coverage ratio is the ratio of funds eligible for SCR coverage to the Solvency capital requirement.
Gearing ratio	The gearing ratio indicates the relative proportion of shareholders' equity used to finance total assets. It is calculated by dividing Total Liabilities by Total Assets.
Dividend payout ratio	The dividend payout ratio is the ratio of the total amount of dividends paid out to shareholders relative to the net income of the Group/Company.

Explanation of Equity Research Ratings

Buy: Based on a current 12- month view of total shareholder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total shareholder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, we do not recommend either a Buy or Sell. Current shareholders should consider buying on dips and selling on peaks.

Newly issued research recommendations and target prices supersede previously published research.

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