

## Qualitas Controladora S.A.B. de C.V.

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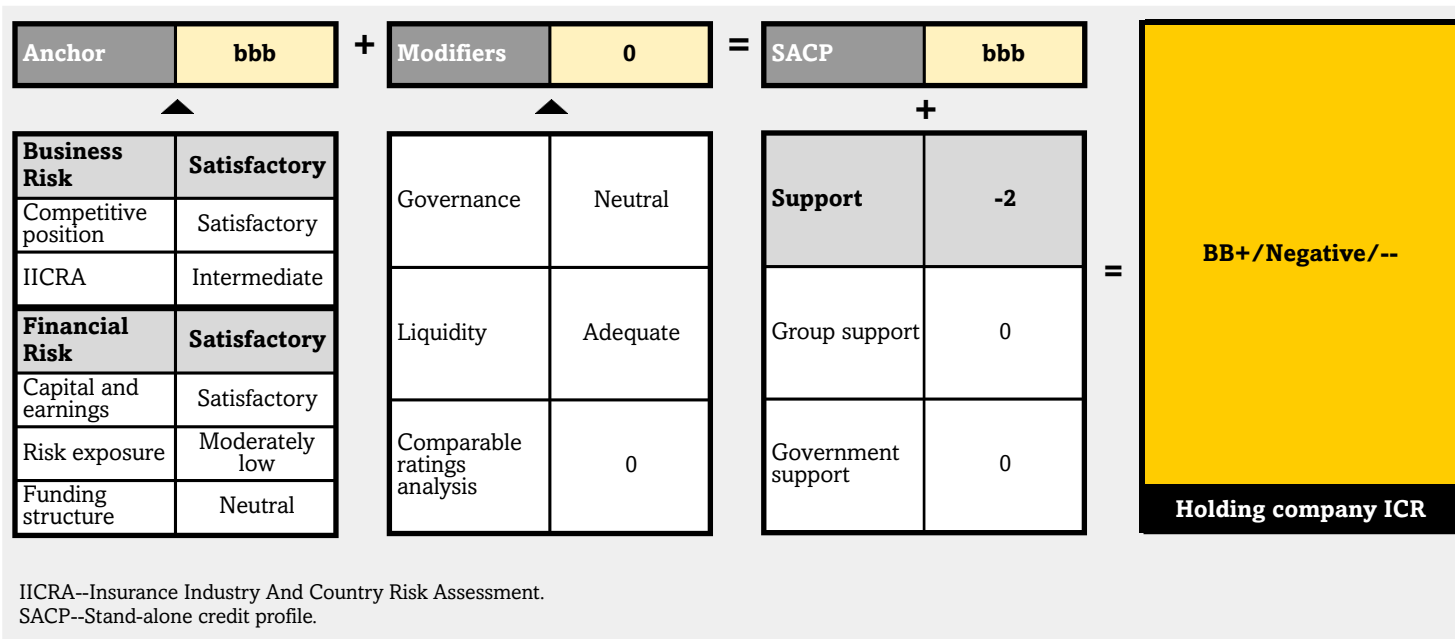
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# Qualitas Controladora S.A.B. de C.V.



## Credit Highlights

Overview	
Strengths	Risks
Strong brand recognition.	Lack of business diversification because Quálitas Controladora S.A.B. de C.V. is solely focused on auto insurance.
A leading player in the Mexican auto insurance sector.	Geographic concentration, because 93% of Quálitas' business is in Mexico.
Solid earning generation capacity.	Exposure to multi-year policies slightly increased during 2020 and could pressure profitability if claims deviate from our base-case scenario.

**Ratings on QualCon reflect structural subordination to policyholders' obligations.** Quálitas Controladora S.A.B. de C.V. (QualCon) is the non-operating holding company and parent of Quálitas Compañía de Seguros (Quálitas Compañía; mxAA+/Stable/mxA-1+) and Quálitas Insurance Co. (QIC; BBB-/Negative/--), which focuses on the Mexico-U.S. cross-border business. We refer to the three entities as Quálitas. QualCon also has smaller insurance operations in El Salvador, Costa Rica, and Peru.

Our rating on QualCon is two notches below the GCP, reflecting the degree of structural subordination to policyholders' obligations. Quálitas Compañía is the main operating subsidiary; therefore, the national scale ratings on it reflect creditworthiness of Quálitas' core subsidiaries. Finally, our rating on QIC reflects its highly strategic subsidiary status. Therefore, the rating is one notch below Quálitas group credit profile (GCP).

**Strong brand recognition.** Despite Mexico's GDP contraction, Quálitas' strong brand recognition has allowed it to post marginal growth this year.

**Significantly lower auto insurance claims will offset the 38% drop in investment income.** However, we expect Quálitas to report its highest earnings of the past five years.

**The company's record of somewhat aggressive capital management,** including high dividend payouts and share repurchase programs limit our assessment. However, if earnings are consistent and the stability of capital adequacy is beyond our expectations, we could revise our capital and earnings assessment to a stronger category.

## Outlook: Negative

The negative outlook on the QualCon and QIC global scale ratings reflects that on the sovereign rating, which constrains Quálitas' group creditworthiness. Therefore, if we downgrade the sovereign in the next 12-24 months, we could take a similar action on QualCon and QIC.

### Upside scenario

We could revise in the next two years our outlook on QualCo and QIC to stable if we revise our outlook on Mexico to stable. However, we consider this unlikely given the negative outlook.

## Key Assumptions

### Macroeconomic assumptions

We forecast a 9.3% contraction in Mexico's GDP this year and a growth of 3.9% in 2021. We continue expecting Mexico's economic recovery will take longer than those of most of regional peers, because the damage to the labor market has been more severe, and investment weakness that preceded the pandemic is likely to remain in place after COVID-19 fades.

## Key Metrics

	Sep-20	2019	2018	2017	2016	2015	2014
<b>(Mil. MXN)</b>							
Gross premium written	25,356	36,196	34,495	33,820	30,190	19,856	17,340
Net income (attributable to all shareholders)	5,334	5,358	2,424	2,064	1,301	564	624
<b>(%)</b>							
Financial leverage including pension deficit as debt	1.7	1.7	1.8	2.1	2.0	2.3	2.3
Return on shareholders' equity	45.26	47.27	28.43	29.42	23.54	12.07	15.35
S&P capital adequacy	Satisfactory	Satisfactory	Lower adequate	Lower adequate	Lower adequate	Upper adequate	Upper adequate
Net investment yield	4.60	3.69	3.75	3.92	3.42	3.79	3.76
Net combined ratio: P/C	75.97	84.81	93.32	96.14	94.29	100.02	101.21
Return on revenue	27.36	18.92	11.59	7.86	8.29	3.91	2.50

## Company-specific assumptions

Despite Mexico's economic contraction and the likely weak recovery in 2021, we expect Quálitas to maintain its gross written premium in line with the 2019 level, followed by a 6% growth next year, thanks to its sound individual distribution channels. On the other hand, we forecast a growth of nearly 7% in net premium earned for 2020 due to its multi-year policies portfolio that increased slightly this year, and 10% for 2021 once the individual annual policies are back on track.

By the end of 2020, we expect Quálitas' net income to rise about 20% compared with last year, mainly as a result of the drop in auto insurance claims and partly offset by lower investment income results amid the lower interest rates. We expect the company's loss ratio to remain about 52% and its combined ratio near 80% by the end of 2020. However, once the mobility in the country recovers next year, coupled with the increasing unemployment and insecurity levels in Mexico, we expect Quálitas' loss and combined ratios to climb back to 66% and 95%, respectively. Both ratios will be slightly above the five-year averages of 65% and 93%, respectively. Furthermore, we expect Quálitas to maintain its low expense ratio in the next two years.

Finally, we forecast an average return on revenue (ROR) for 2020-2022 of 14.3%, which will be above the five-year average of 10%. However, we expect an average return on equity (ROE) to be 27% for the same period, below the five-year average of 32%. The latter is supported by an increasing capital base, through larger amounts of retained profits in the past two years.

## Business Risk Profile: Satisfactory

### Insurance industry and country risk

In general, Quálitas faces an intermediate insurance industry and country risk, because its operations are mostly in Mexico (see "Insurance Industry and Country Risk Assessment: P/C Mexico," Feb. 27, 2020).

### Competitive position

In our view, Quálitas' strong brand recognition among customers and agents support its competitive advantage in the Mexican marketplace. Quálitas remains the leading auto insurer in Mexico with a market share above 30% as of September 2020. In addition, the company continues to report sound operating performance, reflected in a five-year average combined ratio of 94%, which is in line with those of the country's top auto insurance competitors. However, we consider that Quálitas' concentration in a single line of business is a disadvantage, compared with market participants with broader business diversifications. This limits our competitive position assessment.

## Financial Risk Profile: Satisfactory

### Capital and earnings

Based on September 2020 figures, we expect Quálitas to report its highest earnings for the past five years. We expect the company's total adjusted capital (TAC) to reach MXN18 billion by the end of the year. However, based on the company's record of somewhat aggressive capital management, including high dividend payouts, share repurchase strategy, and a recovery of its gross written premium in the next two years, we believe its capitalization level will

continue be between our 'A' and 'BBB' rating level categories. However, if its earnings are consistent and capital adequacy is stable beyond our expectations, we could revise our capital and earnings assessment to a stronger category. As of September 2020, the regulatory ratio was 7.0x, according to the company's figures.

### **Risk exposure**

Our risk-based capital model incorporates Qualitas' risks. Although it has one of the largest exposures to equity (12%) in the Mexican insurance industry, the remainder of Qualitas' investment portfolio are government and corporate bonds, reflecting a relatively conservative investment strategy. In addition, Quálitas doesn't underwrite complex risk, and we expect its exposure to multi-year policies will remain below 20% in the next two year.

### **Funding structure**

We don't see significant risk for Quálitas' funding structure during the pandemic, given that all of its operations are funded with capital.

## **Other Key Credit Considerations**

### **Governance**

We consider Quálitas has a skilled senior management. In addition, the company's corporate governance, apart from complying with regulatory requirements, includes board members with significant experience in insurance and other relevant areas, as well as independent directors.

### **Liquidity**

Quálitas maintains a sound liquidity level, and we expect its liquidity ratio to remain above 140% in the next 24 months.

## **Related Criteria**

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Business And Financial Risk Matrix

Business risk profile	Financial risk profile							
	Excellent	Very Strong	Strong	Satisfactory	Fair	Marginal	Weak	Vulnerable
Excellent	aa+	aa	aa-	a+	a-	bbb	bb+	b+
Very Strong	aa	aa/aa-	aa-/a+	a+/a	a-/bbb+	bbb/bbb-	bb+/bb	b+
Strong	aa-/a+	a+/a	a/a-	a-/bbb+	bbb+/bbb	bbb-/bb+	bb/bb-	b+/b
Satisfactory	a	a/a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bb+/bb	bb-/b+	b/b-
Fair	a-	a-/bbb+	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb/bb-	b+/b	b-
Weak	bbb+/bbb	bbb/bbb-	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b/b-	b-
Vulnerable	bbb-/bb+	bb+/bb	bb/bb-	bb-/b+	b+/b	b/b-	b-	b-

**Note:** Where table indicates two possible outcomes, we determine the anchor as follows: For financial risk profiles that we assess as satisfactory or stronger, we consider the relative strength of both the business risk and financial risk profiles within the cell. This is based on a holistic assessment of the relative strengths of the rating factors of the business risk profile and financial risk profile. For financial risk profiles that we assess as fair or weaker, we typically place more weight on the relative strength of the rating factors of the financial risk profile.

## Ratings Detail (As Of December 11, 2020)\*

### Qualitas Controladora S.A.B. de C.V.

Issuer Credit Rating

BB+/Negative/--

### Related Entities

#### Qualitas Compania de Seguros, S.A. de C.V. y Subsidiarias

Financial Strength Rating

*CaVal (Mexico) National Scale*

mxAA+/Stable/--

Issuer Credit Rating

*CaVal (Mexico) National Scale*

mxAA+/Stable/mxA-1+

#### Qualitas Insurance Co.

Financial Strength Rating

*Local Currency*

BBB-/Negative/--

Issuer Credit Rating

*Local Currency*

BBB-/Negative/--

### Domicile

Mexico

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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