

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

**Primary Credit Analyst:**

Juanjaime R Romero, Mexico City +52 5550814441; [juan.jaime.romero@spglobal.com](mailto:juan.jaime.romero@spglobal.com)

**Secondary Contact:**

Ricardo Grisi, Mexico City + 52 55 5081 4494; [ricardo.grisi@spglobal.com](mailto:ricardo.grisi@spglobal.com)

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

<b>Anchor</b>	<b>bbb+</b>	+	<b>Modifiers</b>	<b>0</b>	=	<b>SACP</b>	<b>bbb+</b>	<div><b>BB+/Stable/--</b></div> <div><b>Holding company ICR</b></div>
						<b>+</b>		
<b>Business Risk</b>	<b>Satisfactory</b>					<b>Support</b>	<b>-3</b>	
Competitive position	Satisfactory		Governance	Neutral				
IICRA	Intermediate					Group support	0	
<b>Financial Risk</b>	<b>Strong</b>		Liquidity	Adequate				
Capital and earnings	Strong					Government support	0	
Risk exposure	Moderately low		Comparable ratings analysis	0				
Funding structure	Neutral							

IICRA--Insurance Industry And Country Risk Assessment.  
SACP--Stand-alone credit profile.

## Credit Highlights

### Overview

Key strengths	Key risks
Solid internal capital generation due to good operational efficiency.	High inflation, supply chain disruptions, and tougher economic conditions could damage profitability.
Leader in the Mexican auto insurance market.	Lack of business diversification because it only focuses on the auto segment.
Brand recognition with solid distribution channels.	Significant geographic concentration in Mexico.

*We expect Quálitas group's gross premium written (GPW) to continue growing, but with higher loss ratios.* We believe the group will maintain its leading position in the Mexican auto insurance sector, with GPW growing 5% annually in 2022-2023. In our view, the group's extensive presence in Mexico and its strong agent channel will support this growth. Moreover, we consider the group will keep enhancing its geographic footprint in the U.S. and Central America for the next two years, but these regions will still contribute less than 15% of its GPW. We also forecast that high inflation and tougher economic conditions will increase claim costs and delinquency rates. This will push up loss ratios to 68% for the next two years--from 65% in 2021--damaging its profitability, although the group has increased efforts in the use of technology, primarily for geolocation and units' recovery, with a recovery rate above the industry average. Also, the group has been proactive in strengthening different risk prevention initiatives.

*Despite the difficult economic conditions, we believe Quálitas group's capital will continue strengthening through its cumulative profits.* Although we forecast loss ratios to rise, we expect the group to maintain a relatively healthy combined ratio, around 95%, for the following two years due to its efficient expense management. Additionally, its investment income will offset pressure on its technical results, despite market volatility, because it will benefit from the increase in short-term yields. In this sense, we think internal capital generation will be strong enough to support capital

redundancy around 10% above our 'AA' category benchmark for 2022-2023, according to our capital framework.

***We continue to limit Quálitas' group credit profile (GCP) and the ratings by the 'BBB' foreign currency rating on Mexico.***

We limit the Quálitas group's creditworthiness by the foreign currency ratings on Mexico, reflecting our view that the company wouldn't have the capacity to withstand a sovereign default. The latter incorporates that the group operates mainly in the Mexico and solely in the auto insurance segment. Additionally, our rating on Qualitas Controladora S.A.B. de C.V. (QualCon) is two notches below the group's credit profile (GCP), reflecting the degree of structural subordination to policyholders' obligations. Finally, our 'BBB-' local currency rating on Qualitas Insurance Co. (QIC) considers its highly strategic subsidiary status, with the rating one notch below Quálitas' GCP.

## Outlook: Stable

The outlook on QualCon and QIC reflects the outlook on the foreign currency sovereign rating on Mexico, which constrains the group's creditworthiness. Also, the stable outlook on QualCon reflects our view that it will remain a nonoperating holding company (NOHC), with capital levels above our 'AA' benchmark, and a leading player in Mexico's auto insurance market. Finally, the stable outlook on QIC also reflects our expectation that it will remain the main vehicle to enhance the group's geographic footprint.

### Downside scenario

A negative rating action on Mexico would result in a similar action on QualCon and QIC. Moreover, if their respective stand-alone credit profiles (SACPs) worsen beyond our base-case assumptions, we could also lower the ratings on these entities. This could happen, for example, if we observe a significant decrease in the group's GPW, or an extraordinary increase in its loss ratios, resulting in a material capital reduction. However, we don't expect any of these scenarios.

### Upside scenario

We could revise the outlook to positive if we take a similar action on the sovereign.

## Assumptions

- Given the weakening of the U.S economy and the high inflation, we forecast Mexico's GDP growth for 2022 at 1.7% and 1.9% for 2023.
- We expect inflation rates in Mexico at 6.2% at the end of 2022 and 3.5% in 2023.
- Interest rates around 9.25% in 2022 and 8.00% in 2023, and exchange rate at MXN20.50 per \$1 in 2022 and MXN21 per \$1 in 2023.

**Qualitas Controladora S.A.B de C.V.--Key Metrics**

	--Year ended Dec. 31--						
	2023f	2022f	2021	2020	2019	2018	2017
<b>(Mil. MXN)</b>							
Gross premium written	42,000-42,500	40,000-40,500	38,224.3	36,056.7	36,196.4	34,494.9	33,819.9
Net income (attributable to all shareholders)	2,500-2,700	2,000-2,200	3,777.9	6,798.1	5,358.1	2,424.3	2,063.6
Return on shareholders' equity	12-14	10-12	19.2	41.7	47.3	28.4	29.4
S&P capital adequacy	AA	AA	AA	AA	BBB	Below BBB	Below BBB
Property/casualty: Net expense ratio (%)	26-28	26-28	26.8	27.0	25.5	27.2	29.2
Net combined ratio: P/C	94-96	94-96	90.6	78.3	84.8	93.3	96.1
Return on revenue	9-10	8-9	11.7	24.9	18.9	11.6	7.9
Return on assets (excluding investment gains/losses) (%)	4-5	4-5	6.3	14.5	11.7	7.3	5.2

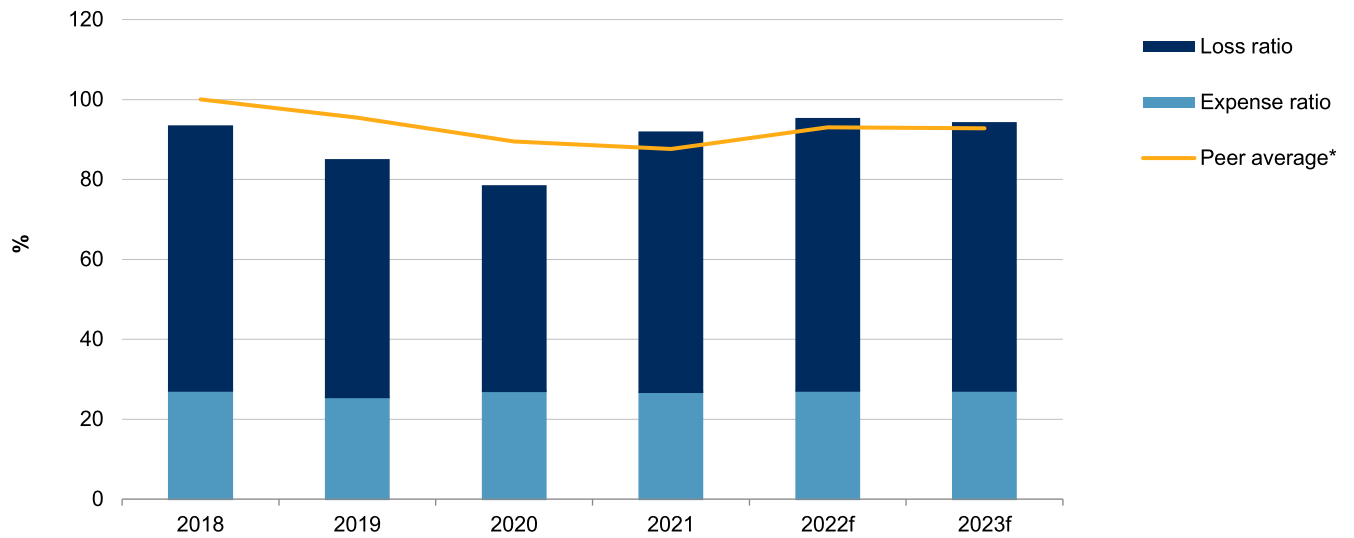
**Business Risk Profile: Satisfactory**

Qualitas group faces an intermediate insurance industry and country risk because its operations are based solely in the auto insurance market and are mostly in Mexico (See "Insurance Industry And Country Risk Assessment: Mexico P/C And Health", April 2, 2022).

In our opinion, Quálitas group will continue benefiting from a competitive advantage as the leading company in Mexico's auto insurance market. As of June 2022, it accounted for around 30.1% of the auto insurance market share by GPW in Mexico, underpinned by its good brand recognition among clients, strong agent network, and solid presence throughout the country. We expect this leading market share to be reflected in a solid operating performance, but one that's lower than in 2021 given the challenging economic conditions. In this sense, we expect a combined ratio around 95.0% for 2022-2023, compared to 91.8% in 2021, due to the rise in claims. Finally, Quálitas' concentration in a single business line and in Mexico--89% of total GPW--limits our competitive position assessment.

**Chart 1**

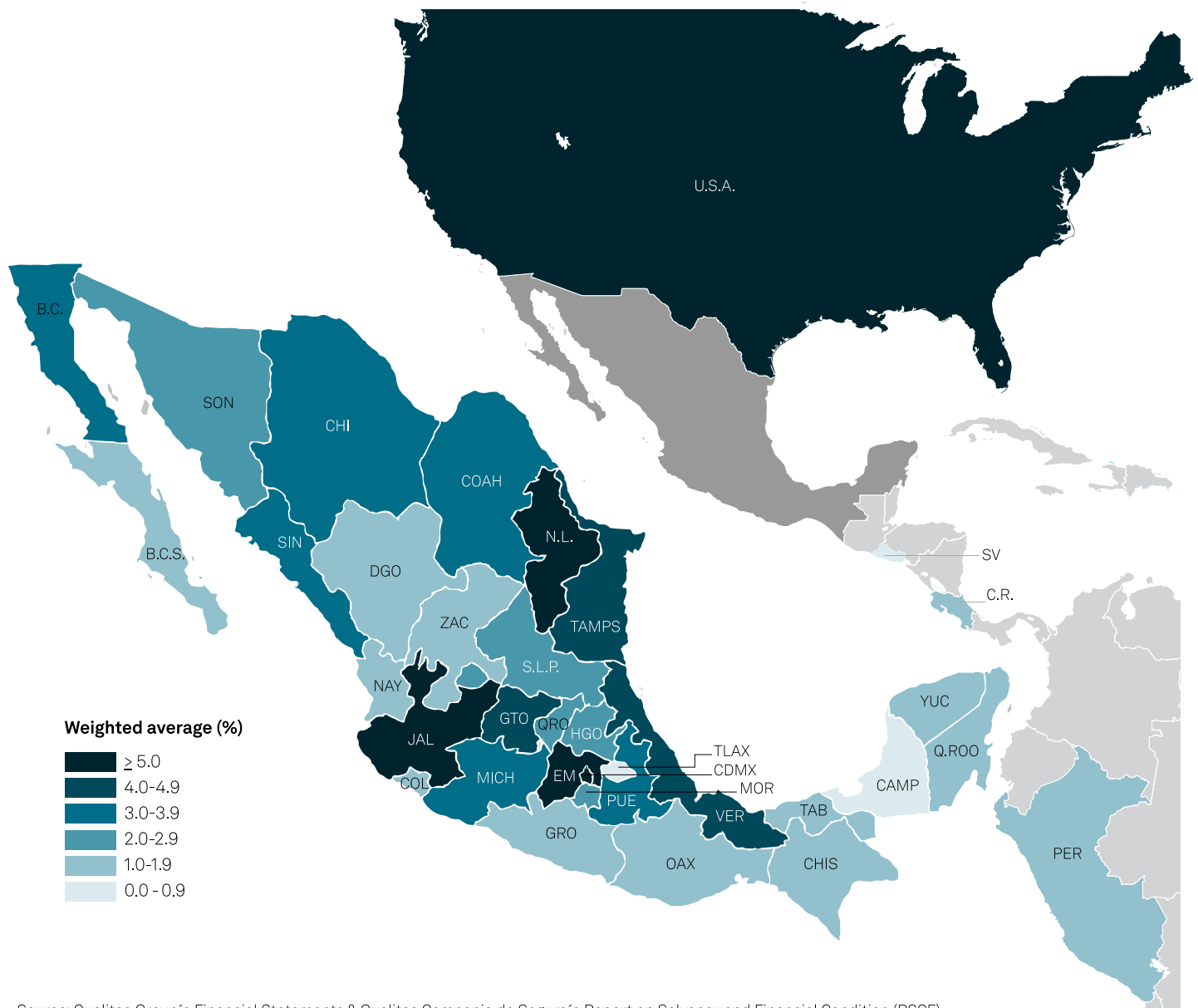
**Qualitas Group's Combined Ratio Breakdown**



Source: S&P Global Ratings. \*Peers considered: AXA Seguros S.A. de C.V., HDI Seguros S.A. de C.V., Seguros Atlas S.A., Chubb Seguros Mexico S.A.

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## Qualitas Group's Footprint

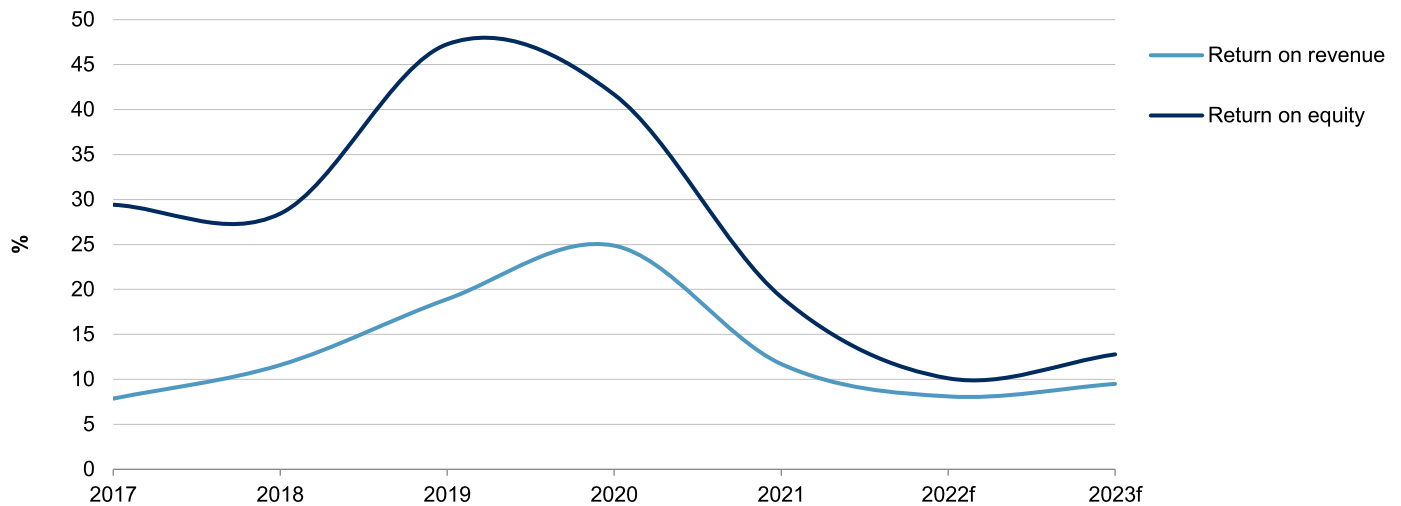


Source: Qualitas Group's Financial Statements & Qualitas Compania de Seguro's Report on Solvency and Financial Condition (RSCF)  
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We expect Qualitas group's net income will decrease to between MXN2.0 billion-MXN2.2 billion during 2022, due to the rebound in the auto insurance claims' frequency and the increase in claim costs as a consequence of rising inflation. These factors will translate into a return on equity between 10%-12% and a return on revenue between 8%-9% in 2022, below its 2021 results of 19.16% and 11.71%, respectively. However, for 2023, we believe the group's performance will gradually recover until it stabilizes in 2024 with net income over MXN3.0 billion.

Chart 2

## Qualitas Group's Profitability Metrics



f--Forecast. Source: S&P Global Ratings.

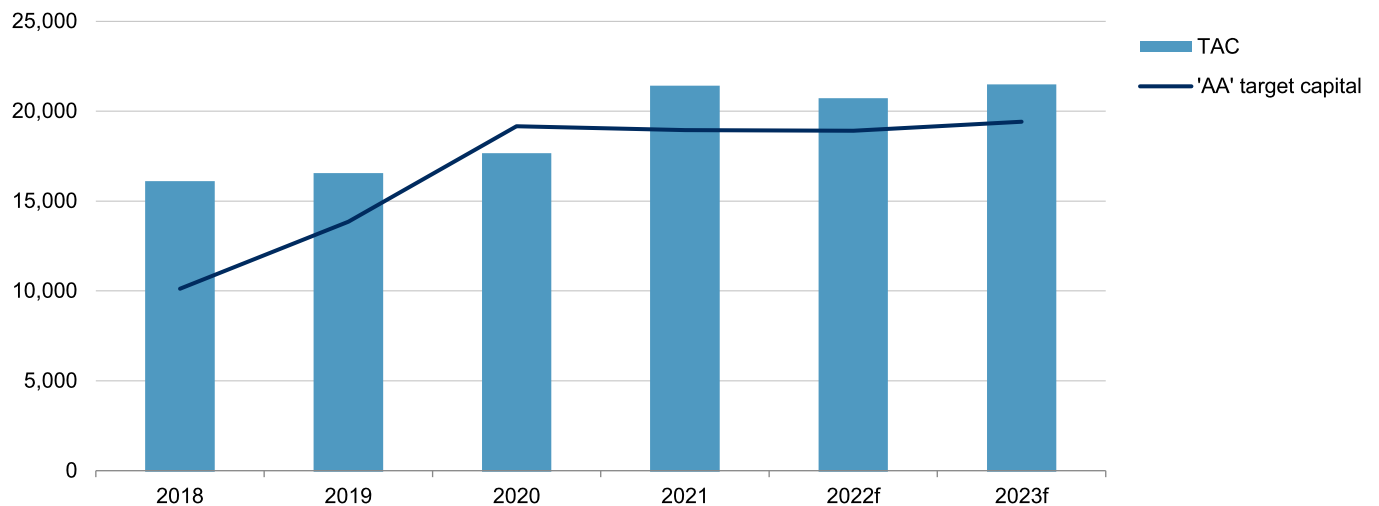
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## Financial Risk Profile: Strong

Even though we expect Quálitas group's net income will decrease this year, it will be enough to maintain solid internal capital. We expect Quálitas to have total adjusted capital (TAC) about 10% above our 'AA' category benchmark, according to our capital framework, since we estimate internal capital generation will surpass the modest GPW growth and the conservative approach on its investment portfolio given market volatility. However, we expect the TAC to remain close to MXN20 billion-MXN22 billion, as in 2021, in the following two years, somewhat limiting our financial risk profile assessment. Finally, the regulatory solvency ratio was 4.1x, according to the company's figures as of June 2022, and we expect it to keep similar levels for the next 24 months.

Chart 3

## Qualitas Group's TAC And Target Capital



f--Forecast. Source: S&P Global Ratings.

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In our opinion, the group will continue to have moderately low risk exposure because it doesn't underwrite complex products and doesn't have appetite for complex risks. Although its business model is entirely focused on auto insurance, it has had sound results. Even though Quálitas group has one of the largest exposures to equity (15.4%) in the Mexican insurance industry as of June 2022, we expect it to reduce this proportion to 12.0%-13.0% by the end of 2022. The drop reflects the group's strategy to maintain short-term liquidity due to the current market volatility. Additionally, the rest of its investment portfolio is comprised by government and corporate bonds, which we consider conservative and in line with other Mexican peers.

We don't foresee material risk for Quálitas group's funding for the next 24 months because its operation is 100% funded with capital.

## Other Credit Considerations

### Governance

In our view, Quálitas group's board has fair independence and complies with the regulatory requirements. Top management is responsive to all stakeholders' interests, including the board of directors as the ultimate decision-making body. Also, we consider the group has an adequate team of second-tier managers with broad experience and responsibilities are adequately delegated.



## Liquidity

Qualitas group has adequate liquidity. We expect our liquidity ratio to remain near 179% for the next 24 months given the group's conservative investment strategy that is focused on short-term liquidity.

## Factors specific to the holding company

Our rating on the holding company is two notches lower than its GCP, reflecting standard notching for Mexico-based holding companies that depend on operating insurance subsidiaries to meet its obligations. Qualitas' performance and liquidity benefits from its operating subsidiaries' underlying earnings strength and dividend-paying capacity.

## Group support

In our view, QIC remains a highly strategic subsidiary for Qualitas, reflecting its importance in boosting long-term business expansion outside Mexico. Moreover, we believe there is a strong commitment from the group in case of a stress scenario through capital injections. Finally, we believe that the company's growth and performance will remain sound, making the U.S. subsidiary attractive for the group and highly unlikely to be sold.

## Environmental, social, and governance

### ESG Credit Indicators

E-1	<b>E-2</b>	E-3	E-4	E-5	S-1	<b>S-2</b>	S-3	S-4	S-5	G-1	<b>G-2</b>	G-3	G-4	G-5
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ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumeric 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

ESG factors have no material influence on our credit rating analysis of QualCon. Extreme weather events could increase its claims, but its exposure to environmental risk factors is lower than insurers that operate catastrophe insurance. Moreover, it has implemented several ESG initiatives that include sustainability risk mitigation and social responsibility strategies, which is line with its peers. Finally, governance practices comply with local regulators and are in line with the Mexican insurance industry.

## Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

## Appendix

### Qualitas Controladora S.A.B. de C.V.--Credit Metric History

(Mil. MXN)	2022*	2021	2020	2019	2018	2017
Total invested assets	38,356.9	39,053.5	38,860.3	31,852.6	30,565.1	27,529.9
Total shareholder equity	18,540.2	20,378.7	19,061.1	13,564.4	9,104.6	7,950.8
Gross premium written	19,496.7	38,224.3	36,056.7	36,196.4	34,494.9	33,819.9
Net premium written	19,169.8	37,922.9	35,675.9	35,991.3	34,183.0	33,604.0
Net premium earned	19,186.7	36,067.3	36,291.3	34,898.7	31,809.6	28,667.7
Reinsurance utilization (%)	1.7	0.8	1.1	0.6	0.9	0.6
EBIT	1,633.6	4,764.4	9,361.8	7,291.9	3,447.4	2,607.6
Net income (attributable to all shareholders)	1,391.3	3,777.9	6,798.1	5,358.1	2,424.3	2,063.6
Return on revenue (%)	N/A	11.7	24.9	18.9	11.6	7.9
Return on assets (excluding investment gains/losses) (%)	N/A	6.3	14.5	11.7	7.3	5.2
Return on shareholders' equity (%)	N/A	19.2	41.7	47.3	28.4	29.4
Property/casualty: Net combined ratio (%)	93.0	91.8	78.3	84.8	93.3	96.1
Property/casualty: Net expense ratio (%)	26.0	26.8	27.0	25.5	27.2	29.2
Property/casualty: Return on revenue (%)	9.4	9.2	18.5	14.1	8.9	6.2
Financial obligations/adjusted EBITDA (x)	N/A	0.1	0.0	0.0	0.0	0.1
Financial leverage including pension deficit as debt (%)	2.2	1.7	1.6	1.7	1.8	2.1
Net investment yield (%)	N/A	4.1	4.2	3.7	3.7	3.9
Net investment yield including investment gains/(losses) (%)	N/A	4.9	3.6	4.6	2.0	4.8

\*Data as of June 30. N/A--Not applicable.

### 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
<b>Satisfactory</b>	a	a/a-	<b>a-/bbb+</b>	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 September 13, 2022)\*

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

Issuer Credit Rating

BB+/Stable/--

## Ratings Detail (As Of September 13, 2022)\*(cont.)

**Related Entities****Qualitas Compania de Seguros, S.A. de C.V. y Subsidiarias**

Financial Strength Rating

*CaVal (Mexico) National Scale*

mxAAA/Stable/--

Issuer Credit Rating

*CaVal (Mexico) National Scale*

mxAAA/Stable/mxA-1+

**Qualitas Insurance Co.**

Financial Strength Rating

*Local Currency*

BBB-/Stable/--

Issuer Credit Rating

*Local Currency*

BBB-/Stable/--

**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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