

LatAm Auto Insurance

Initiating coverage – Temporary roadblocks

The auto insurance sectors in Brazil and Mexico offer sustainable, long-term growth potential, in our view, with favorable market dynamics

The industry faces near-term headwinds such as lower interest rates, the repricing cycle, and policy uncertainty; our sensitivity analysis examines these risks

We initiate coverage of Porto Seguro with a Hold, as its strong franchise faces short-term earnings risk; and Qualitas with a Reduce given demanding valuation metrics and increased country risk



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Executive summary

- ◆ The auto insurance sectors in Brazil and Mexico offer sustainable, long-term growth potential, in our view, but faces short-term headwinds
- ◆ Porto Seguro (Hold), Brazil's leading non-life insurer, faces near-term earnings risk; we expect a 2023-26e EPS CAGR of 4%
- ◆ Qualitas (Reduce), Mexico's top auto insurer has an impressive growth story, but valuation looks demanding and we add country risk

LatAm auto insurance - primed for growth: The outlook for the auto insurance sectors in Brazil and Mexico is promising due to structural factors such as low penetration, the easing credit environment facilitating vehicle sales, stabilizing economies, rising motorization, and a favorable regulatory environment contributing to long-term top-line growth ([page 12](#)). After substantial repricing post-pandemic, we expect moderate auto premium growth in 2024 in Brazil and Mexico, driven by further pricing adjustments as well as the evolution of industry costs. We forecast a 2023-30 auto gross written premium (GWP) CAGR of c7% in Brazil and c8% in Mexico.

Sector faces near-term earnings challenges: (1) **falling interest rates**, which should reduce investment income as the sector's profitability is highly and positively correlated with the level of interest rates; and (2) **pricing adjustments** that are nearing completion, which will affect GWP growth. Additionally, growth of the auto insurance industry is typically linked to GDP growth, so LatAm economies' current slowdown in response to higher rates may impact the industry ([page 4](#)).

Porto Seguro (Hold, TP BRL33) is Brazil's leading underwriter in the auto, residential, and commercial P&C insurance segments. Over the years, the company has diversified its revenue base from auto insurance to health, P&C, life, and other non-insurance products. However, these diversification efforts have yielded limited benefit thus far, in our view. Earnings face near-term headwinds from: (1) a slowdown in premium growth as the company nears completion of its tariff adjustments; (2) lower investment income as policy rates come down. We run sensitivity analysis ([page 30](#)); and (3) increased claim costs as it plans to expand further into health insurance, which typically incurs higher costs. We forecast a 2023-26e EPS CAGR of only 4%. Valuation looks attractive at 8.2x 2024e PE, but it lacks potential catalysts in the short term, in our view.

Qualitas (Reduce, TP MXN165), Mexico's leading auto insurance company, has shown consistent growth (2010-23e premium CAGR of 14%); increased its market share organically from 20% in 2010 to 33% in 2023, a feat hard to replicate; and has maintained solid underwriting performance, resulting in strong profitability (avg 2010-23 ROAE of c26%). In LC, the stock rose c88% in 2023 and is up 6% YTD, despite a 17% decline following the presidential election outcome. We highlight that Qualitas is the second most-liquid stock in the financial sector in Mexico. We view it as a quality company with significant growth opportunities. However, valuation looks quite demanding in absolute terms; the stock is trading at 2024 PBV of 3.0x and PE of 12.3x, a 35% premium to its 3 yr. historical average PBV and a 16% premium to PE. Additionally, the company faces risk from a tax-related contingency. We have applied an additional 100bp risk premium to incorporate higher policy risk in Mexico and analyze the sensitivity of our TP ([page 7](#)).

Ratings and target prices

Company	Ticker	Mkt cap 6M ADTV		CMP	TP	Rating	Up/down side (%)	PE (x)		PBV (x)		ROAE (%)		Div yield (%)		Price perf (% LC)	
		(USDm)	(USDm)					2024e	2025e	2024e	2025e	2024e	2025e	2024e	2025e	YTD	12M
Porto Seguro	PSSA3 BZ	3,575	9.8	29.66	33.00	Hold	11.3	8.2	7.8	1.44	1.33	18.3	17.6	6.5	6.7	3	11
Qualitas	Q* MM	3,951	11.7	181.59	165.00	Reduce	(9.1)	12.3	10.5	2.99	2.68	25.7	27.0	4.4	5.7	6	53

Source: Bloomberg, HSBC (priced at close of 13 June 2024)

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Investment thesis

- ◆ We believe the auto insurance sectors in Brazil and Mexico will sustain long-term growth, but face short-term risks
- ◆ We initiate coverage on Porto Seguro (Hold, TP BRL33). It has a strong franchise in Brazil with diversified revenue base, but faces short-term earnings headwinds; attractive valuation discount
- ◆ We initiate coverage on Qualitas (Reduce, TP MXN165). This is a quality company with steady EPS growth (19% 2010-23 CAGR), but valuation appears high and we have increased the country risk (CoE)

Sector is promising due to structural factors

Positive view on the LatAm auto insurance sector

We believe the outlook for the auto insurance sectors in Brazil and Mexico is positive due to several structural factors, such as:

- ◆ **Low insurance penetration:** Total insurance penetration in Brazil and Mexico remains low compared to DM and some EM, which should allow the insurers to experience sustained growth in the long term. As of 2022, the ratio of Gross Written Premium (GWP) to GDP stood at 4.0% in Brazil and 2.4% in Mexico vs 11.6% in the US, 10.4% in the UK, 5.0% in Malaysia, and 4.0% in India ([page 12](#)). Auto insurance penetration (auto GWP-to-GDP) was c0.58% in Brazil and 0.53% in Mexico as of 2023.
- ◆ **Reaping the benefits of stable economies:** The growth of the auto insurance industry is directly linked to the growth of the local economies, and we see significant growth opportunities in both Brazil and Mexico. We anticipate that the current GDP growth rate of c2% (vs avg 2013-19 real GDP growth of 0.2% in Brazil and 1.7% in Mexico), along with the decrease in inflation and stable exchange rates could lead to a rise in domestic car sales.
- ◆ **Easing credit environment facilitating vehicle sales:** With declining inflation and easing interest rates, we expect to see a gradual pick-up in total loan growth. This positive trajectory should enhance consumer purchasing power and fuel growth in vehicle sales. This, in turn, should positively impact multiple segments of the insurance industry and result in higher earnings for insurers.
- ◆ **A rise in motorization** (number of vehicles per 1,000 inhabitants): LatAm's motorization rate still lags some regions, but there is a rising trend of vehicle ownership. This presents growth opportunities and a large market for Brazilian and Mexican insurers. According to OICA data, vehicle numbers have been growing at an average rate of c4% in Mexico and c1.5% in Brazil ([page 16](#)).

Key macro-economic indicators and auto premium growth

	GDP growth (% y/y)		CPI, end-year (% y/y)		Policy rate, end-year (%)		Auto GWP growth (% y/y)	
	2024e	2025e	2024e	2025e	2024e	2025e	2024e	2025e
Brazil	2.0	2.3	3.9	4.1	10.50	10.00	6.5	7.0
Mexico	2.1	1.8	3.9	3.6	10.00	7.50	12.1	6.7

Source: HSBC

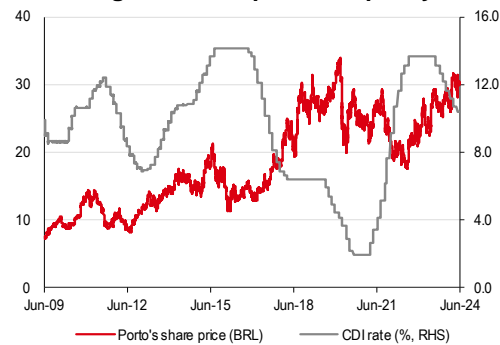
The sector faces near-term headwinds from lower interest rates, the repricing cycle, policy uncertainty and higher competition

Short-term challenges for the sector

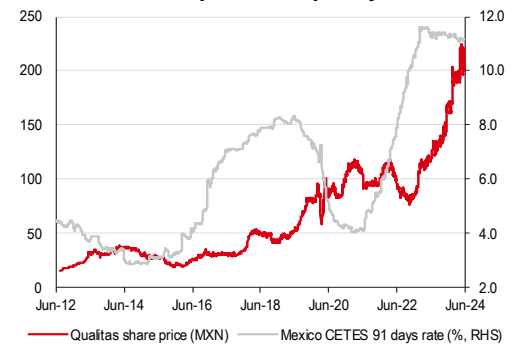
However, we see the following challenges for the sectors in the near term.

- ◆ **Macro volatility:** The growth of the auto insurance industry and gross written premium (GWP) are usually directly associated with GDP growth. LatAm economies are already slowing in response to higher interest rates, and any additional obstacles to economic activity could lead to a slowdown in vehicle sales and a decrease in top-line growth of the auto insurance companies.
- ◆ **Falling interest rates could cause financial income to stagnate:** In general, non-life insurance companies generate relatively healthier profitability due to strong financial income. Hence, as shown in the charts below, their profitability and share prices have a high and positive correlation with the level of interest rates in the country.
- ◆ **Competition.** The Mexico and Brazil markets have a significant presence of insurers focused on the auto insurance segment (c30-35 insurers in Mexico and Brazil). Additionally, subsidiaries of large financial groups also have a significant presence in the insurance sector. Furthermore, as each country constitutes a single insurance market (unlike the US, where insurance is regulated at the state level, rather than the federal level), they are relatively easy to enter and exit. The last decade has seen market consolidation in the LatAm auto insurance market, especially in Brazil, which has been favorable for pricing. The top five auto insurers in Brazil now account for 75% of premiums, up from 52% in 2010, and 70% of premium in Mexico vs 65% in 2010.
- ◆ **Regulatory changes.** Both markets are heavily regulated by various government bodies. These include the Superintendent's Office for Private Insurance (SUSEP) in Brazil and the Comisión Nacional de Seguros y Fianzas (CNSF) in Mexico, and each country's Ministry of Finance. Regulatory changes have been favorable so far, but any adverse change may impact the companies' profitability (see [page 18](#)).

Porto Seguro: Share price and policy rate



Qualitas: Share price and policy rate



Auto insurance – country outlook

- ◆ **Brazil:** In the last two years, despite economic headwinds from high inflation and tight monetary conditions in Brazil, auto insurance premium growth for the sector has remained high, mostly driven by tariff increases post-pandemic and a modest recovery in new vehicle sales. The total auto insurance market in 2023 reached total gross written premiums (GWP) of BRL56bn, reflecting a 2012-23 CAGR of 7.6%. The auto segment's total GWP accounted for c13% of the total insurance GWP in 2023.

- ◆ **Mexico:** Similar to the Brazilian market, the Mexican auto insurance industry has also experienced solid growth in the last few years, benefitting from pricing adjustments, improved macro environment, and emerging opportunities from nearshoring. The total auto insurance market in 2023 reached total GWP of MXN153bn, reflecting a 2012-23 CAGR of 8.4%. The auto segment's total GWP accounts for c19% of the total insurance GWP in 2023.

After strong growth post-pandemic (2022-23 growth of 8-15% in Brazil and 11-27% in Mexico), we expect moderate auto premium growth in 2024e in both countries, driven by additional pricing adjustments as well as the evolution of industry costs. We forecast a 2023-30e auto GWP CAGR of c7% in Brazil and c8% in Mexico.

Investment recommendation

Despite the promising long-term growth prospects for the auto insurance sectors in Brazil and Mexico, and favorable market dynamics, we initiate coverage on Porto Seguro at Hold due to short-term earnings challenges and on Qualitas at Reduce due to valuation considerations and an increase in country risk.

Porto Seguro is a strong franchise in Brazil with diversified revenue base, but faces short-term earnings headwinds; attractive valuation discount

Porto Seguro (Hold, TP BRL33.0, 11.3% upside)

Porto Seguro is the largest non-life insurance group in Brazil and a leading underwriter in the auto (28% market share), residential (22% market share), and commercial P&C insurance (24.6% market share) segments. Over the years, the company has diversified its revenue base, expanding from auto insurance to health (14% of total revenues), P&C (7% of total revenues), life (4% of total revenues), and other non-insurance products, which include credit operations (11% of total revenues) and other services. While the diversification efforts have yielded slightly better results in terms of growth (total revenues grew at a 2017-23 CAGR of 12% vs NEP growth of 10%) and increased customer engagement, it has seen very limited benefits so far in terms of cost or earnings growth, in our view. It also introduced higher leverage into its financial structure as the company diversified its portfolio to include credit services (E/A ratio declined from 29% in 2013 to 22% in 2023). Porto has a strong distribution network of agents with access to Itau's (largest Brazilian private bank in assets) extensive sales and distribution channels across Brazil. Additionally, Porto Seguro has provided a decent dividend yield (10-yr average of c5.2%).

However, we expect earnings to face challenges in the coming years from: **(1)** a slowdown in premium growth as the company nears completion of its tariff adjustments, and due to modest growth in new vehicle sales trends. We expect 7.5% GWP growth in 2024e vs 15-28% growth in the last two years; **(2)** lower financial income from investments as policy rates continue to come down in Brazil. Large parts of Porto's operating income is derived from investment income; and **(3)** increased claim costs as the company plans to expand further into health insurance, which typically incurs higher costs. We see the stock trading at 8.4x 2024e PE, which does not seem expensive; however, it may lack potential catalyst in the short-term as we expect earnings to face challenges in the coming quarters.

Additionally, we highlight the fact that the company has improved its disclosure practices by providing a detailed breakdown of its four verticals (Porto Seguro, Porto Saude, Porto Bank, and Porto Serviço), which aids in comprehensive analysis, and has started providing 2024 guidance for each vertical. Porto also announced registration requests for two of its verticals (Porto Saude and Porto Serviço) as issuers of securities in category 'A' at CVM, potentially leading to a liquidity event in the future (IPO or debt issuance).

Our EPS forecasts are largely in line with Visible Alpha consensus for 2024e-26e. We expect 3% y-o-y EPS growth in 2024e, followed by 5% growth in 2025e, and 4% growth in 2026e. We initiate coverage with a Hold rating and target price of BRL33. Our target price implies a 2024e PE of 9.2x and PBV of 1.6x for an ROE of 18.3%. *For more details see [page24](#).*

Qualitas is a quality company in Mexico with significant growth opportunities, and potential to pay higher dividends, but valuation looks quite demanding in absolute terms

Qualitas (Reduce, TP MXN165.00, 9.1% downside)

Qualitas is Mexico's leading auto insurance company, with a market share of c33% in terms of GWP, 2.4x the size of the second largest insurer in the market (GNP, with c13% share). Over the past decade, the company has: **(1)** delivered consistent growth (2010-23 premium CAGR of 13%) well above the industry; **(2)** organically increased its market share from 20% in 2010 to 33% in 2023, a significant achievement that is hard to replicate; and **(3)** maintained solid underwriting performance that has allowed it to deliver strong ROAEs (avg 2010-23 ROAE of c26%). We also highlight that over the last few years, the trading liquidity of the stock has improved significantly, with an average 6-month ADTV of cUSD12m (from USD1m 5 years ago) vs cUSD8m for SME lenders Regional & Bajio and 5-6m for Inbursa and Genera. The company's market cap is now cUSD4.0bn and represents c1.44% of the Mexican IPC Index (MEXBOL. Qualitas was added to MEXBOL in Apr 2020).

In 2023 and so far this year, Qualitas has emerged as one of the strongest performing stocks in LatAm, rising c88% in 2023 and 6% YTD in LC. Despite the stock declining 17% in LC since the presidential election's outcome was announced, its valuation metrics still look rich. Qualitas stock is currently trading at a 2024e PE of 12.3x and PBV of 3.0x, a 16% premium to its 3-years historical average PE and 35% premium to its 3-years historical average PBV. Additionally, the company faces risk from a tax-related contingency.

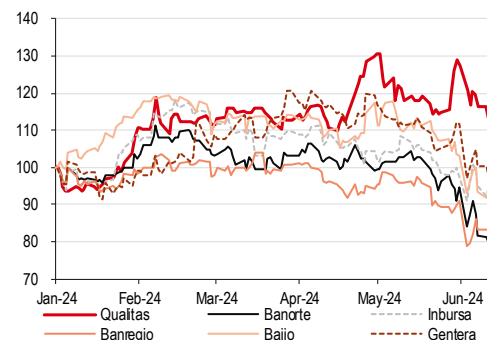
Our EPS forecasts are 2% below Visible Alpha consensus for 2024e and 3-6% below for 2025-26e. We initiate coverage with a Reduce rating and a TP of MXN165. *For more details see [pg40](#).*

What could make Qualitas more attractive?

We see Qualitas as a high-quality company with significant growth opportunities in all of its operating countries. It has the potential to deliver sustainable ROEs of above 20%, and the possibility of providing higher dividends given its strong capital position (solvency ratio is at 336% as of 1Q 2024). It is also the second most-liquid stock in the financial sector in Mexico. Qualitas stock outperformed bank stocks in 2023 and YTD. However, valuation metrics currently appear rich (2024e PE of 12.4x vs 7-8x for Banorte and Inbursa and 6-7x for Regional and Bajio, [page 10](#)). In our view, the stock could be more attractive, with: (1) an improvement in valuation metrics relative to the bank stocks or in absolute terms; (2) a resolution of tax-related contingency; and (3) a lower cost of equity, influenced by the public policies of the new administration. In our valuation, we have applied an additional 100bp risk premium to our cost of equity assumption to incorporate higher policy risk in Mexico after ruling party Morena gained an unexpected large supermajority in Congress. This mandate would allow it to approve the constitutional changes that outgoing president AMLO proposed earlier in the year. If none of those risks were to materialize, however, our sensitivity analysis suggests the fair value of the stock could be improved by 16% [page 7](#). Our target price implies 11.2x 2024e PE and 2.7x PBV.

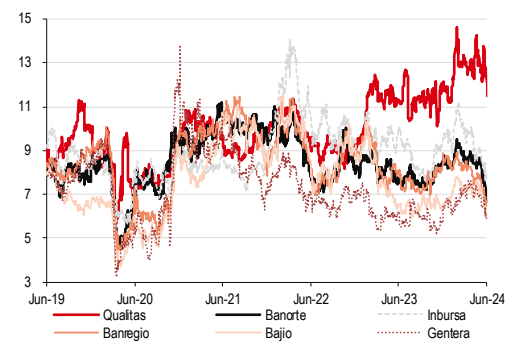
Qualitas stock outperformed bank stocks in 2023 and YTD

Mexican financials: Price performance (rebased to Jan 2024)



Source: Refinitiv Datastream

Mexican financials: 1-yr fwd PE (x)

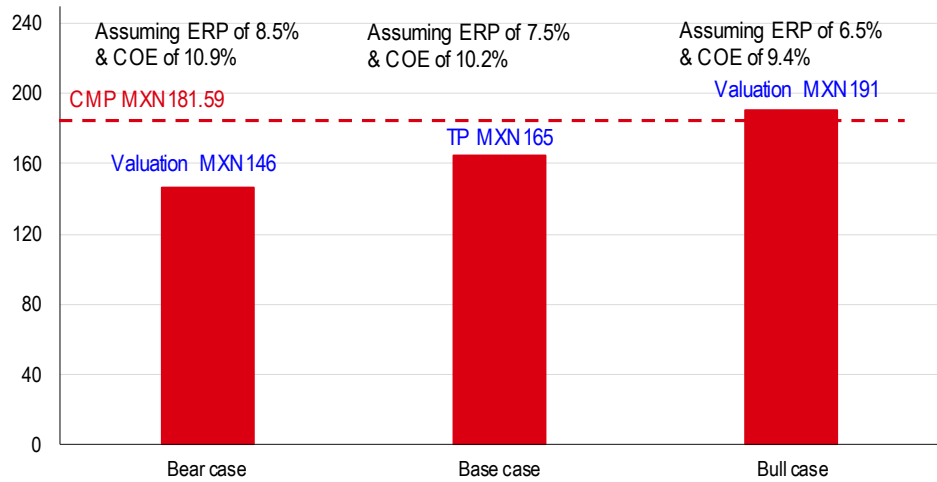


Source: Refinitiv Datastream

Sensitivity analysis

In the following chart, we show sensitivity of our valuation to various levels of equity risk premium and cost of equity.

Qualitas: Sensitivity of valuation to changes in equity risk premium (ERP)



Source: HSBC. Closing price as of 13 June 2024

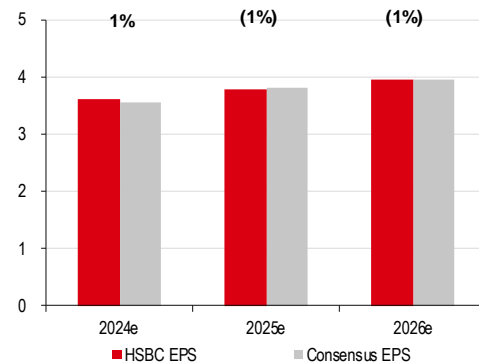
Valuation methodology

We derive our target prices for Porto Seguro and Qualitas using a blended valuation approach of multi-period dividend discount model (DDM 50%), economic profit model (EPM 30%), and target PE implied by ROE (20%), which is in-line with the valuation technique used for the banks under our coverage (page 19). We also show the sensitivity analysis of our target prices to various levels of equity risk premium and growth assumptions (page 22).

Where we are vs consensus

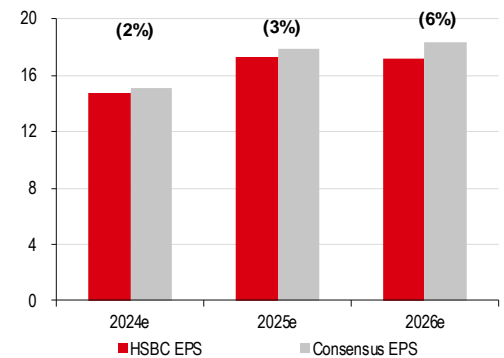
For Qualitas, our 2024e EPS forecast is 2% below Visible Alpha consensus and our 2025-26e forecasts are 3-6% below consensus (due to impact from lower rates on financial income). HSBC economists expect faster rate cuts in Mexico vs in Brazil in 2025e. For Porto Seguro, our 2024-26e EPS forecasts are largely in line with Visible Alpha consensus.

Porto Seguro: HSBC vs consensus (BRL)

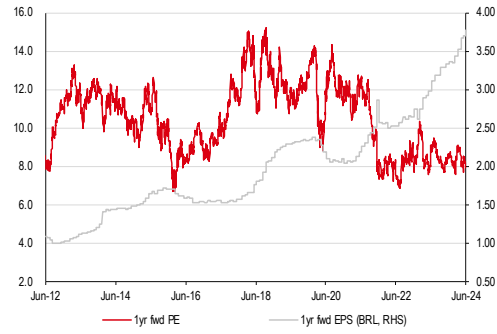


Source: HSBC, Visible Alpha

Qualitas: HSBC vs consensus (MXN)



Source: HSBC, Visible Alpha

Porto Seguro: 1-yr fwd PE (x) and EPS


Source: Refinitiv Datastream

Qualitas: 1-yr fwd PE (x) and EPS


Source: Refinitiv Datastream

Valuation table

Valuations – Auto and Composite Insurers

Companies	Bloomberg code	M Cap (USDm)	6M ADTV Price (USDm)	cur	Price	TP	Rating	P/E (x)			EPS CAGR	P / BV (x)			ROAE (%)			Div yield (%)	
								2023	2024e	2025e	2023-25e	2023	2024e	2025e	2023	2024e	2025e	2024e	2025e
Auto and composite insurers								23.1	14.1	12.4	11%	3.61	3.02	2.61	13.2	19.7	19.3	2.8	4.0
Auto insurers								31.6	16.4	14.4	11.4%	5.99	4.89	4.00	15.3	27.0	25.4	2.1	4.4
Qualitas	Q* MM	3,951	11.7	MXN	181.59	165.00	Reduce	19.0	12.3	10.5	34.7%	3.36	2.99	2.68	18.5	25.7	27.0	4.4	5.7
Porto Seguro	PSSA3 BZ	3,575	9.8	BRL	29.66	33.00	Hold	8.5	8.2	7.8	3.9%	1.57	1.44	1.33	19.9	18.3	17.6	6.5	6.7
Progressive Corp	PGR US	119,248	494.2	USD	203.60	227.00	Hold	33.4	17.0	15.8	3.7%	7.49	5.87	4.70	19.8	30.9	27.0	1.3	2.0
Allstate Corp	ALL US	42,446	253.1	USD	160.83	190.00	Buy	nm	13.2	9.5	28.6%	2.51	2.39	2.18	1.4	17.4	21.7	2.3	2.4
Hagerty*	HGTY US	3,478	0.5	USD	10.33	-	-	54.4	49.9	37.3	44.1%	na	8.13	7.46	21.8	na	na	1.1	92.8
Admiral Group	ADM LN	9,995	13.3	GBP	25.57	26.60	Hold	23.1	15.7	16.1	6.6%	na	na	na	na	na	na	6.1	5.9
Direct Line Insurance Group	DLG LN	3,237	7.9	GBP	1.93	2.39	Hold	12.3	12.3	8.9	21.8%	na	na	na	na	na	na	12.4	12.8
Sabre Insurance*	SBRE LN	505	0.7	GBP	1.58	-	-	21.8	10.8	9.2	10.7%	1.63	1.55	1.50	7.7	14.1	16.0	3.1	na
Linea Directa Aseguradora*	LDA SM	1,293	1.1	EUR	1.11	-	-	nm	26.3	17.3	36.3%	3.85	3.53	3.36	(1.4)	14.4	19.3	nm	4.1
Multiline insurers								19.8	13.0	11.4	10.4%	2.32	1.99	1.83	11.8	15.4	15.8	3.4	4.2
Travelers Cos	TRV US	47,418	292.5	USD	207.07	225.00	Hold	15.8	11.2	10.0	11.5%	2.28	1.91	1.77	13.1	16.5	16.8	2.0	2.2
Great-West Lifeco *	GWO CN	26,471	94.0	CAD	39.00	-	-	13.3	9.1	8.7	3.5%	1.51	1.49	1.39	11.6	16.7	16.7	0.4	0.8
Intact Financial Corp *	IFC CN	28,933	86.2	CAD	222.89	-	-	31.9	15.2	14.2	8.0%	2.73	2.46	2.24	8.5	16.9	18.5	2.4	na
Sampo Oyj	SAMPO FH	21,352	29.8	EUR	39.63	45.00	Hold	15.2	17.2	15.8	8.4%	2.74	2.85	2.75	15.7	16.5	17.9	4.2	4.5
Beazley	BEZ LN	5,598	11.7	GBP	6.67	7.70	Buy	4.4	5.5	4.7	na	1.38	1.14	0.99	30.0	18.9	18.8	2.2	2.4
Hiscox	HSX LN	4,867	8.2	GBP	11.14	12.60	Hold	5.5	6.7	6.0	12.6%	1.17	1.03	0.89	27.6	17.3	17.4	2.8	2.9
Lancashire Holdings	LRE LN	1,850	2.9	GBP	5.94	7.45	Buy	4.5	4.7	4.4	na	na	na	22.7	19.6	19.2	9.6	9.6	
Tryg	TRYG DC	12,764	13.1	DKK	143.90	180.00	Buy	24.0	17.4	16.1	7.6%	2.32	2.31	2.31	9.4	13.3	14.5	5.4	5.7
Topdanmark	TOP DC	3,769	3.8	DKK	291.00	366.38	Hold	24.9	18.3	17.3	5.2%	5.55	5.05	4.92	19.0	28.9	28.8	5.5	5.8
Turkiye Sigorta	TURSG TI	2,826	6.7	TRY	78.65	69.60	Buy	14.8	6.0	5.3	12.3%	5.92	3.11	2.12	56.4	67.6	47.8	1.0	3.3
Anadolu Anonim Turk Sigorta*	ANSGR TI	1,750	5.5	TRY	113.10	-	-	8.9	nm	nm	nm	4.63	na	na	75.2	na	na	14.9	na
Aksigorta AS*	AKGRT TI	418	5.6	TRY	8.39	-	-	11.8	nm	nm	nm	4.18	na	na	44.4	na	na	6.8	na
Tokio Marine Holdings*	8766 JT	67,905	155.2	JPY	5,472.00	-	-	29.2	16.4	13.3	15.1%	3.04	2.37	2.18	9.9	16.3	15.4	1.4	2.7
Samsung Fire & Marine	000810 KS	11,328	23.4	KRW	330,500	377,500	Buy	7.2	6.0	5.7	6.1%	0.82	0.76	0.70	13.5	13.2	12.9	6.1	6.6
Hyundai Marine & Fire	001450 KS	2,095	10.3	KRW	32,350	51,000	Buy	3.1	2.2	2.1	3.0%	0.41	0.39	0.34	15.8	18.5	17.6	7.4	8.3
DB Insurance Co	005830 KS	5,318	12.1	KRW	103,200	119,000	Buy	4.0	3.3	3.3	2.6%	1.21	1.00	0.89	17.7	20.2	17.8	6.1	6.2
PICC Property & Casualty	2328 HK	27,882	37.4	HKD	9.79	11.70	Buy	8.9	7.4	6.7	10.9%	0.94	0.86	0.79	10.9	12.2	12.3	5.8	6.4
People's Insurance Co Group	1339 HK	27,976	10.4	HKD	2.65	2.90	Hold	6.4	4.7	4.4	na	0.50	0.45	0.42	7.9	10.1	9.8	6.9	7.3
ICICI Lombard General	ICICIGI IN	9,813	16.5	INR	1,662.70	1,990.00	Buy	47.2	42.7	35.3	20.8%	7.86	6.85	6.03	17.6	16.9	17.8	0.7	0.8
New India Assurance	NIACL IN	4,769	9.2	INR	241.77	-	-	38.0	nm	nm	nm	1.89	0.87	0.82	5.1	nm	na	1.1	na

*Bloomberg estimates
Note: Priced at close of 13 June 2024
Source: Bloomberg, HSBC estimates

Valuations – Mexican and Brazilian Financials

Companies	Bloomberg code	Rating	MV (USDm)	6M ADTV (USDm)	Latest price	Target price	HSBC PE (x)			EPS CAGR 23-25e	P/BV			ROAE (%)			ROAA (%)			Div. yield (%)	
							2023	2024e	2025e		2023	2024e	2025e	2023	2024e	2025e	2023	2024e	2025e	2024e	2025e
GF Banorte	GFNORTEO MM	Hold	21,466	74.2	132.68	190.00	7.3	6.8	6.8	3%	1.53	1.45	1.38	21.6	21.8	20.7	2.4	2.4	2.2	9.6	10.3
GF Inbursa*	GFINBURO MM	-	13,830	5.7	41.96	-	na	na	na	10%	na	na	na	13.7	14.2	13.4	4.3	4.1	3.9	4.0	3.9
Banco del Bajío	BBAJIOO MM	Hold	3,276	8.2	51.14	72.00	5.5	5.7	6.5	(8%)	1.46	1.40	1.31	28.3	25.1	21.0	3.4	3.0	2.4	14.6	10.5
Regional	RA MM	Hold	2,255	7.9	127.78	178.00	7.4	6.7	6.8	4%	1.48	1.31	1.22	21.2	20.7	18.5	2.6	2.6	2.4	6.1	9.0
Gentera	GENTERA* MM	Buy	2,024	5.4	23.08	32.00	7.7	6.6	6.0	14%	1.42	1.26	1.13	19.1	20.3	20.0	5.8	6.0	5.8	6.5	7.6
Qualitas	Q* MM	Reduce	3,951	11.7	181.59	165.00	19.0	12.3	10.5	34.7%	3.36	2.99	2.68	18.5	25.7	27.0	4.6	6.2	6.4	4.4	5.7
Bolsa Mexicana	BOLSAA MM	Buy	959	2.8	31.69	41.00	12.4	11.7	10.8	7%	2.47	2.45	2.31	19.9	21.0	22.0	16.7	17.4	18.5	6.8	6.8
Corp Actinver*	ACTINVRB MM	-	463	0.1	16.15	-	na	na	na	nm	na	na	na	na	na	na	na	na	na	na	na
Findep	FINDEP* MM	-	174	0.1	9.00	-	na	na	na	nm	na	na	na	na	na	na	na	na	na	na	na
Mexico			48,398				8.7	7.5	7.3	8%	1.78	1.64	1.55	19.4	20.1	19.2	3.6	3.7	3.5	7.5	7.5
Itau Unibanco	ITUB4 BZ	Hold	53,231	31.50	31.17	36.00	8.7	7.8	7.4	9%	1.71	1.68	1.56	20.8	21.8	22.0	1.3	1.4	1.4	8.4	8.8
Bradesco	BBDC4 BZ	Hold	23,585	12.69	12.70	16.00	8.3	7.2	5.2	26%	0.84	0.79	0.74	9.6	11.3	14.7	0.8	0.9	1.1	7.0	9.2
Santander Brasil	SANB11 BZ	Hold	18,622	27.04	27.00	33.00	10.8	7.3	5.9	36%	1.17	1.08	0.97	11.1	15.4	17.5	0.8	1.1	1.2	6.8	5.9
Banco do Brasil	BBAS3 BZ	Buy	28,092	26.54	26.72	35.00	4.2	4.0	4.0	3%	0.93	0.83	0.74	20.5	20.6	19.0	1.6	1.6	1.5	11.0	11.3
Porto Seguro	PSSA3 BZ	Hold	3,575	9.8	29.66	33.00	8.5	8.2	7.8	4%	1.57	1.44	1.33	19.9	18.3	17.6	4.4	4.1	3.9	6.5	6.7
Brazil			127,106				7.9	6.8	6.0	18%	1.3	1.2	1.1	17.2	18.6	19.2	1.2	1.3	1.3	8.5	8.7

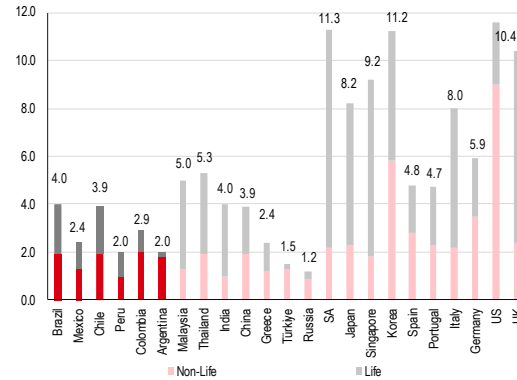
*Bloomberg estimates; price for Mexican companies is in MXN and for Brazilian companies in BRL

Note: Priced at close of 13 June 2024

Source: Company information, Refinitiv DataStream, Bloomberg, HSBC estimates

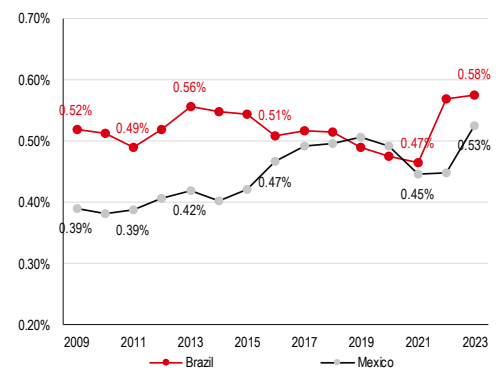
LatAm auto insurance market

Underpenetrated insurance market provides solid growth potential (%)*



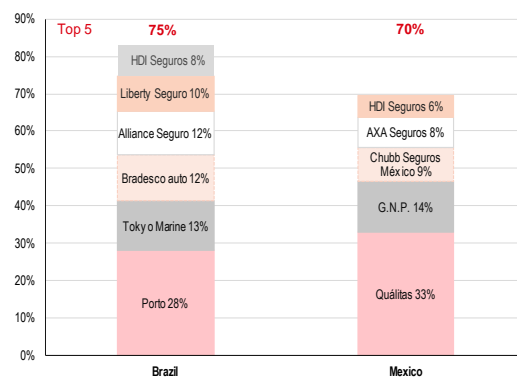
Source: SwissRe Sigma, AMIS, HSBC. *GWP-to-GDP (%)

Rising trends in auto insurance penetration



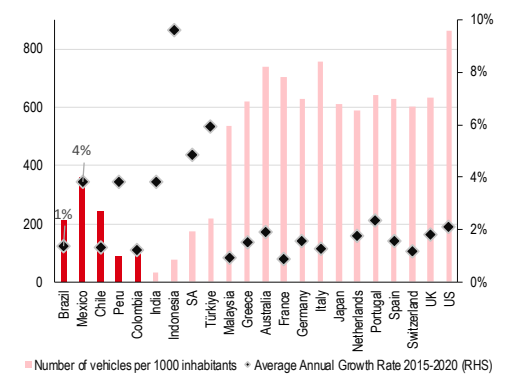
Source: Susep, AMIS, HSBC

Auto insurance market looks concentrated in Brazil and Mexico



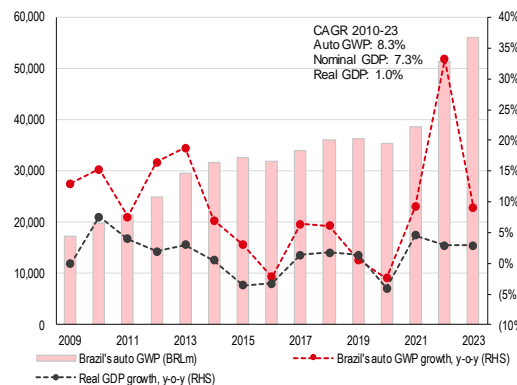
Source: SUSEP, AMIS. AXA Seguros and Chub Seguros are subsidiaries of AXA (France) and Chubb Limited (Switzerland)

Motorization rate increasing, but still lower than in other regions



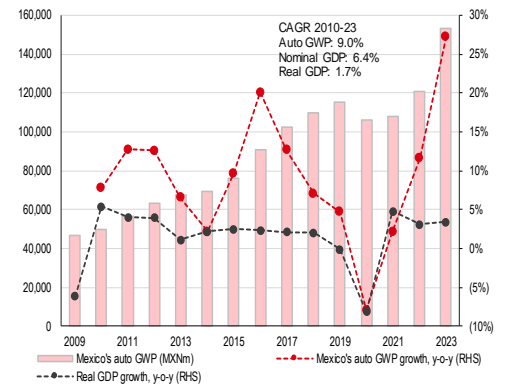
Source: OICA

Brazil: Auto GWP growth vs GDP growth



Source: SUSEP, BCB, HSBC

Mexico: Auto GWP growth vs GDP growth



Source: AMIS, Banxico, HSBC

Overview: LatAm auto insurance sector

- ◆ Mirroring the banking sector in Brazil and Mexico, insurance penetration remains low compared to DM and some EM economies
- ◆ The auto insurance market is concentrated, with the top five insurers accounting for c75% of auto premiums in Brazil and 69% in Mexico
- ◆ LatAm insurers are relatively more profitable vs counterparts in other regions due to better underwriting performance and higher investment income

The auto insurance sector is characterized by intense competition, low entry barriers, lower asset gearing (vs life), higher profitability, and lower volatility (lower beta stocks; insurers depend on agents for product distribution, and customer-focused innovation

LatAm Insurance – market size

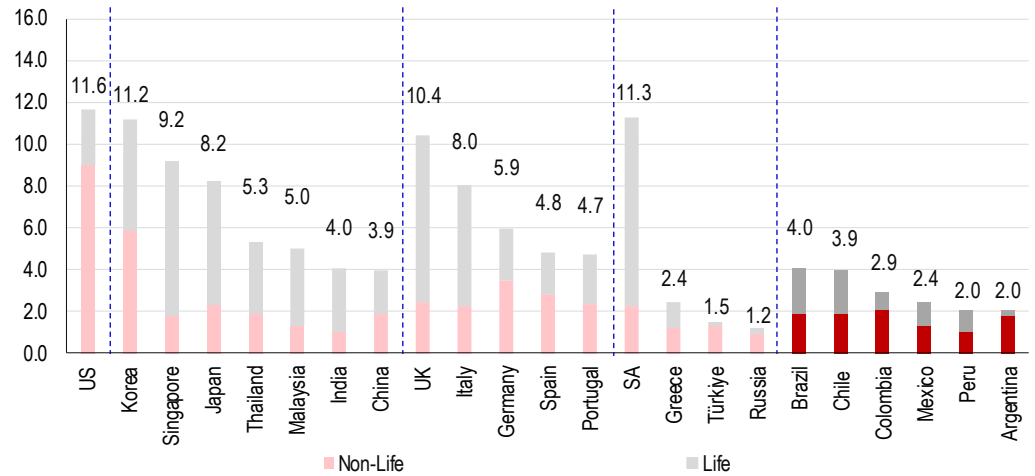
According to data from Swiss Re Institute, global life and non-life insurance premiums totaled cUSD6.8trn in 2022. Total premiums for Latin America and Caribbean were cUSD170bn, accounting for only a c2.5% share of the world market. Of this figure, non-life insurance accounted for a substantial portion, representing 57% of total premiums, while life insurance constituted the remaining 43%. Brazil and Mexico are the largest markets, with total premiums of USD76bn (45% of total LatAm & Caribbean premiums) and USD33bn (20% of the total LatAm & Caribbean premiums), respectively. The auto segment accounts for c13% of total insurance premiums in Brazil and c19% in Mexico.

The companies we are initiating coverage on primarily target the auto insurance. This sector is characterized by intense competition, low entry barriers, lower asset gearing (vs life), higher profitability, and less volatility (lower beta stocks). Auto insurers depend on agents for product distribution and are focused on customer innovation.

Underpenetrated insurance market provides decent growth potential

Mirroring the banking sector in Brazil and Mexico, insurance penetration in both countries remain low compared to developed and some emerging economies, presenting significant growth potential for the sector. As of 2022, the GWP-to-GDP ratio stood at 4.0% in Brazil and 2.4% in Mexico vs 11.6% in the US, 10.4% in the UK, 5.0% in Malaysia, and 4.0% in India. We believe that the low penetration in both countries is largely attributable to structural factors, such as the sizeable informal sector, particularly in Mexico, significant income equality limiting access to financial products, low savings culture and lower disposable income, limited public policies, and economic and political uncertainties leading to a relatively higher inflation rate.

Insurance penetration (% GWP-to-GDP)

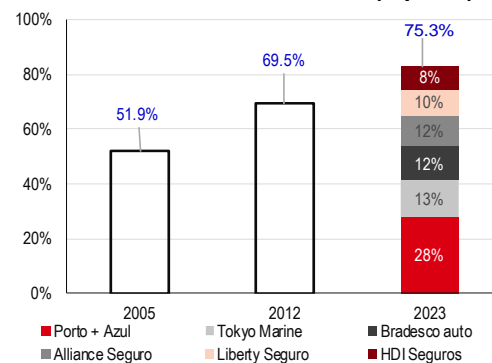


Source: Swiss RE sigma. Data for 2022

Market structure: Concentrated auto insurance market

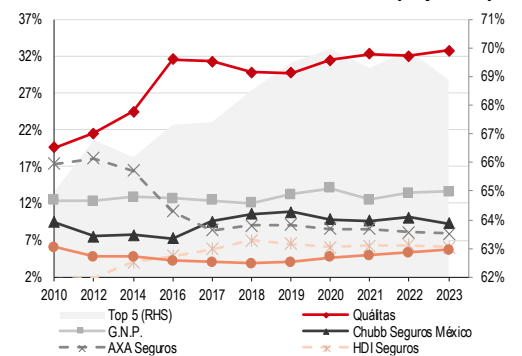
The auto insurance markets in Brazil and Mexico have consolidated over the last decade. In Brazil, market concentration is slightly higher, with the top five insurers holding c75% market share in terms of auto insurance premiums. In November 2023, HDI Seguros, part of Talanx group, announced the acquisition of Liberty Seguros, which should further increase market concentration. Porto Seguro is the market leader, with a market share of c29% and has made several acquisitions in the last few years, including Chubb do Brasil's auto insurance portfolio in 2016 and AIG Seguros Brasil's auto insurance portfolio in 2017. In Mexico, the top five insurers now account for c69% of auto insurance premiums. Qualitas is the market leader with market share of c33%.

Brazil: Auto GWP market share (top five)



Source: Susep. In Nov 2023, HDI Seguros announced acquisition of Liberty Seguros, and thus moved up to number two position

Mexico: Auto GWP market share (top five)



Source: AMIS

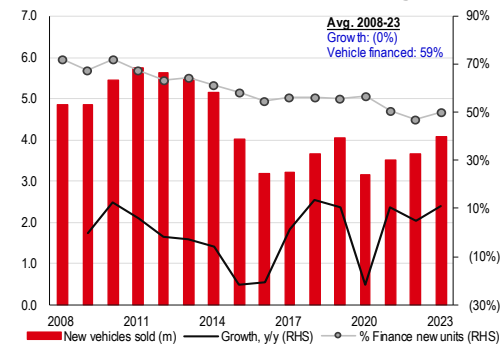
Future growth: Where will it come from?

Annual vehicle sales are regaining momentum after the shocks of the pandemic and tight monetary policy

New car sales regaining momentum; faster growth in Mexico

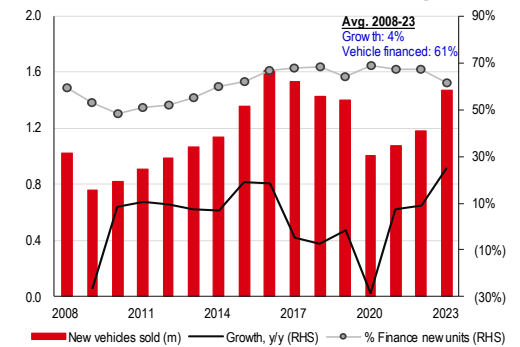
In 2020, the global automobile industry faced significant disruptions from the COVID-19 pandemic, which resulted in a sharp decline in new car sales across the countries. Since then, Brazil has shown a gradual and steady recovery, with new car sales slowly regaining momentum and reaching pre-pandemic levels by 2023. In contrast, new car sales in Mexico have shown resilience over the years, driven by strong export demand, faster economic growth, increased domestic consumption, and growing middle class. Looking ahead, lower inflation and interest rates should be supportive of vehicle demand in Brazil and Mexico. We expect faster growth in Mexico, supported by nearshoring opportunities resulting in strong export demand and increasing domestic consumption. Auto insurance penetration in Mexico increased from 0.42% in 2013 to 0.53% in 2023, whereas in Brazil, it has remained largely stable at 0.58% in 2023 vs 0.56% in 2013.

Brazil: New car sales and financing



Source: B3, Cetip; the Brazilian Association of Automotive Vehicle Manufacturers (ANFAVEA)

Mexico: New car sales and financing

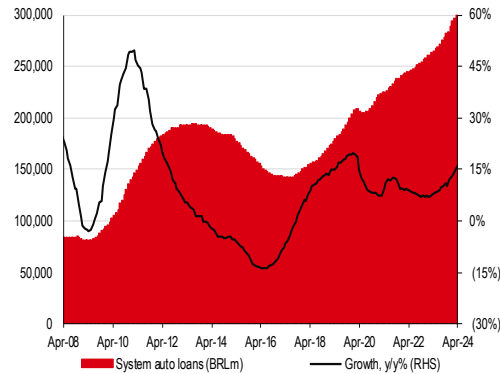


Source: AMIS, Qualitas

Auto financing should rise with lower rates and inflation

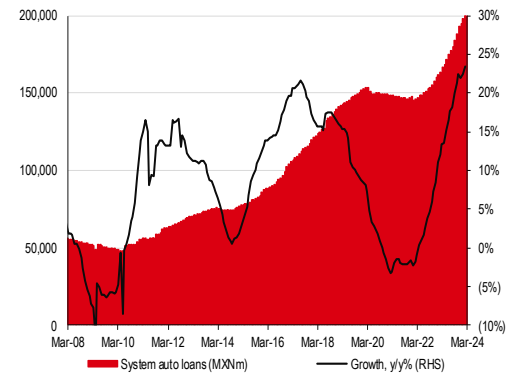
In 2023, **Brazil** navigated through a challenging asset quality cycle, especially in the retail segment, and very high interest rates. As a result, the banks opted for a cautious stance towards loan origination, leading to a significant slowdown in credit growth (system loans grew 8.8% in 2023 vs 14.0% in 2022). In line with this trend, auto financing also slowed, resulting in lower vehicle sales. However, as we look ahead to 2024 and beyond, with declining inflation and easing interest rates, we expect to see a gradual pick-up in total loan growth. This positive trajectory should enhance consumer purchasing power and fuel growth in vehicle sales. In **Mexico**, the consumer segment showed robust growth in 2023 (system loans grew 17.6% in 2023) and, in line with this trend, auto financing also remained steady (22% y/y in 2023). We expect credit growth for Mexican banks should continue to benefit from the structural trends (formalization, low credit penetration), as well as the nearshoring opportunities in coming years.

Brazil: Auto portfolio (BRLm) and growth rate



Source: BCB, HSBC

Mexico: Auto portfolio (MXNm) and growth rate



Source: CNBV, HSBC

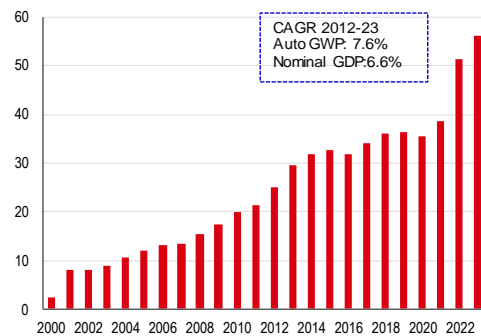
Auto insurance growth is directly linked to economic growth

Over time, auto premium growth has outpaced GDP

The economic cycle is the key driver for the auto insurance industry. Over the past decade, the auto insurance markets in Brazil and Mexico have shown resilience and growth despite facing headwinds from macro uncertainties, disruptions from the COVID-19 pandemic, and global political challenges. The 2012-23 total auto insurance GWP CAGR was c7.6% in Brazil (real growth of 1.9%), and 7.5% in Mexico (real growth of 2.9%). In 2022 and 2023, auto insurance companies in both countries saw significant growth, following a period of weak expansion during the pandemic, partially attributed to pricing adjustments in response to increased vehicle prices, improved economic activity, higher claims resulting from the increased inflation rate, and supply chain constraints. However, despite the robust growth in the last years, market penetration has remained low in these countries, which suggests a substantial untapped potential within these markets, and large opportunities for expansion by insurance companies, in our view.

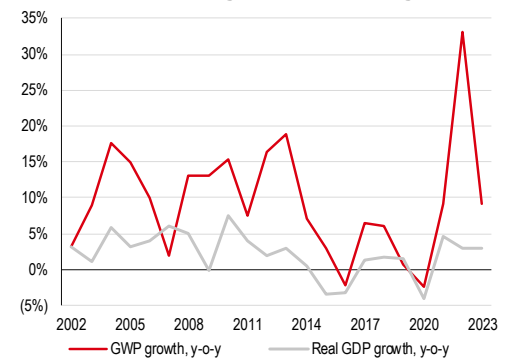
We believe auto insurance growth can be directly linked to economic growth. For Brazil, we forecast total auto GWP growth of c6.5% in 2024e, and a 2023-30e CAGR of 7.3%. For Mexico, we forecast auto GWP growth of c12.1% in 2024e and a 2023-30e CAGR of 8.4%.

Brazil: Auto GWP (BRLbn)



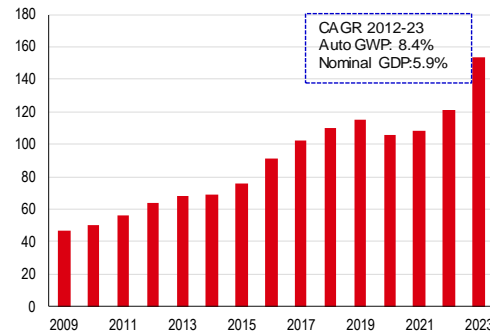
Source: Susep, HSBC

Brazil: Auto GWP growth vs GDP growth



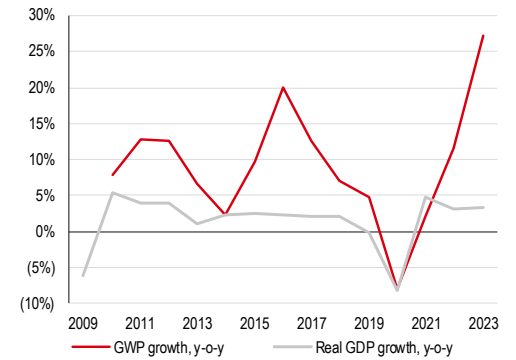
Source: Susep, BCB, HSBC

Mexico: Auto GWP (MXNbn)



Source: AMIS, HSBC

Mexico: Auto GWP growth vs GDP growth

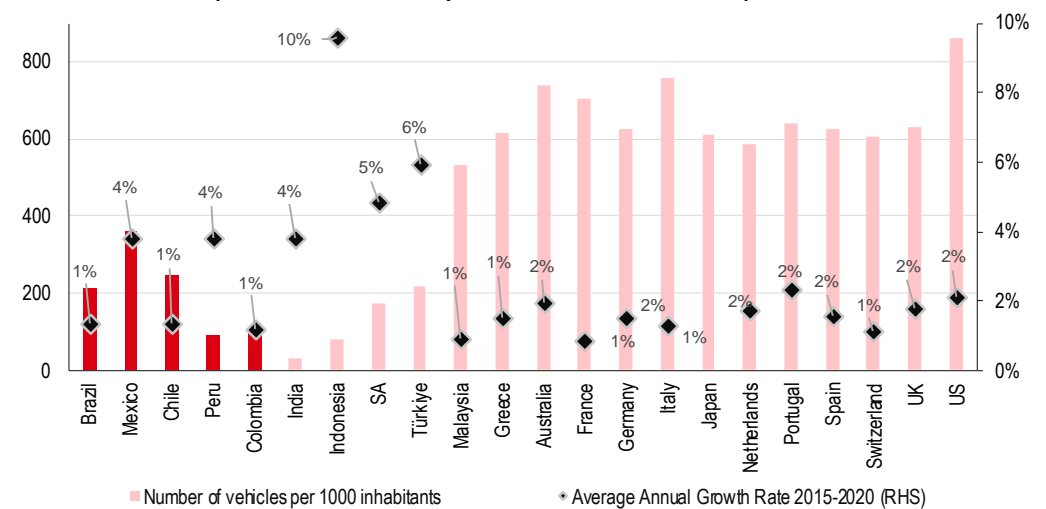


Source: AMIS, Banxico, HSBC

Motorization rate increasing, but still falling behind other regions

LatAm's motorization rate still falls behind that of some emerging and developed regions. Despite this gap, the rising trend of vehicle ownership presents significant growth opportunities and a large market to tap into for the Brazilian and Mexican insurers. According to OICA data, vehicle numbers have been growing at an average rate of c4% in Mexico and c1.5% in Brazil.

Motorization rate (number of vehicles per 1000 inhabitants, 2020)



Source: OICA; motorization rate = total population divided by number of vehicles in use

As of 2022, only c 30% of total vehicles are insured in both Brazil and Mexico

Increasing vehicle ownership shaping the dynamics of the auto insurance sector

Vehicle ownership rates have been growing in Brazil and Mexico, driving demand for auto insurance. According to Globalfleet data for 2022 AMIs, there were c72m vehicles (62m cars and 10m light commercial vehicles) in Brazil and only c30% of vehicles were insured. The situation was similar in Mexico, where there were c48.1m vehicles (including heavy duty trucks), of which only c29-30% were insured. Lower penetration, along with the mandatory nature of auto insurance in both Brazil and Mexico, should allow for wide growth potential in the long term.

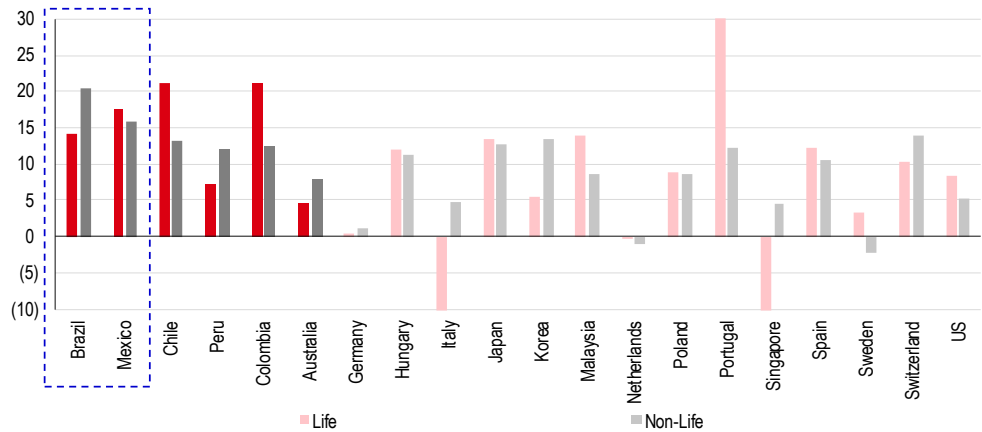
The sector's higher profitability is driven by better underwriting performance and higher investment income resulting from higher interest rates

LatAm non-life insurers excel in profitability

According to the latest global insurance report published by OECD, insurers in Latin America have reported relatively high levels of profitability compared to counterparts in other regions. The average ROAE for Brazil and Mexico in 2022 was c25%. The sector's higher profitability has been driven by better underwriting performance and higher investment income resulting from higher interest rates. This helps insurance companies offset the relatively limited operational gains within the region.

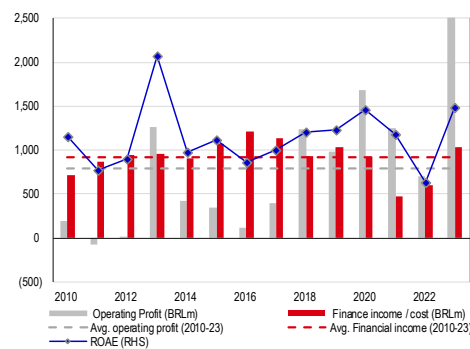
Focusing specifically on the auto insurance sector, 50% of Qualitas' profit before tax (PBT) was from financial income (2010-13 average), with the remaining 50% coming from underwriting income. Meanwhile, 59% of Porto Seguro's PBT was from financial income (avg during the same period). We expect profitability for the LatAm auto insurance sector should improve in 2024, supported by further pricing catch up from the new pricing schedules introduced in 2023, higher average interest rates, and reduced claims severity as inflation rates retreat from recent highs.

Return on average equity (ROAE) by type of insurer (% , 2022)



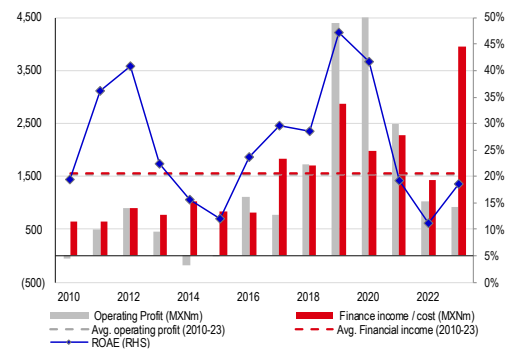
Source: OECD; The return on equity (ROE) is calculated by dividing net income in 2022 by the average shareholder equity in 2021 and 2022

Porto Seguro: Operating profit and financial income



Source: Company data

Qualitas: Operating profit and financial income



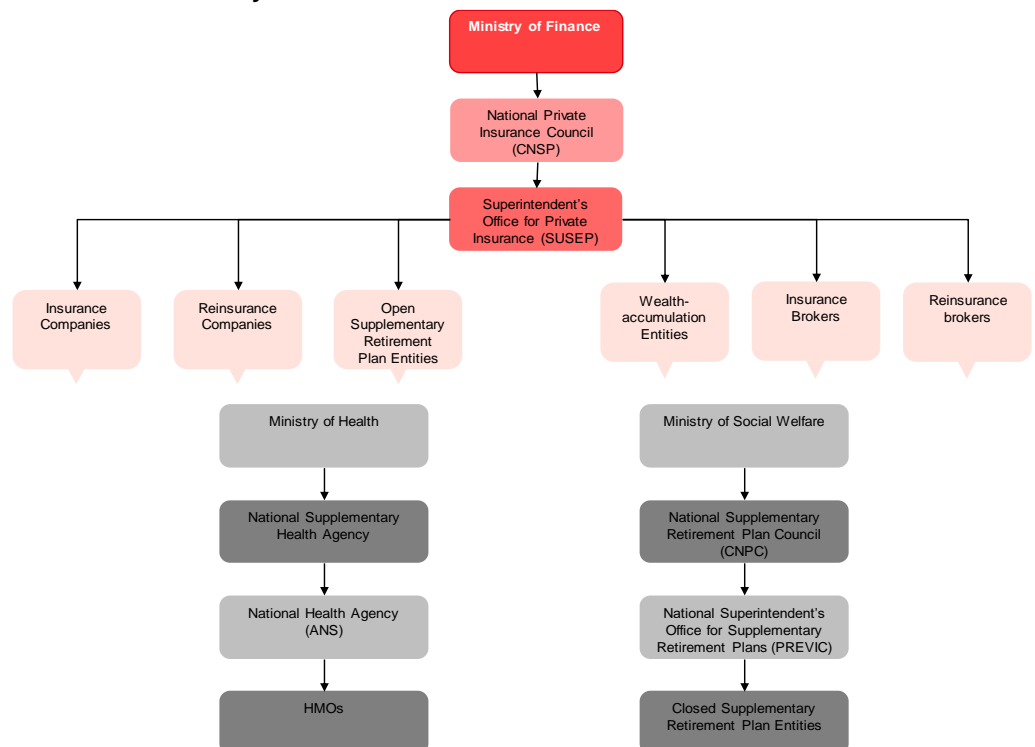
Source: Company data

Regulatory agencies

Brazil's insurance industry is regulated by two government bodies that report to the Ministry of Finance. CNSP (the National Private Insurance Council) is responsible for establishing the norms and guidelines for performing insurance, reinsurance, and wealth accumulation activities. SUSEP (The Superintendent's Office for Private Insurance) is the main insurance regulator in Brazil and is responsible for regulating the norms established by CNSP. However, its authority does not cover all segments of the insurance, reinsurance, private pension, and capitalization industry. ANS (National Supplementary Health Agency) regulates the health insurance market and PREVIC (the National Superintendent's Office for Supplementary Retirement Plans) regulates the closed private pension funds.

Mexico's insurance industry follows the guidelines and regulatory framework established by the Insurance Company Law (LISF, *the Ley de Instituciones de Seguros y de Fianzas*). The LISF defines the role of the industry regulator, the national insurance commission (CNSF, *the Comisión Nacional de Seguros y Fianzas*), an independent agency within the Ministry of Finance.

Brazilian Insurance system



Source: HSBC

Mandatory insurance

Brazil: By law, all vehicles must be insured to a third-party liability level. The road tax in Brazil includes compulsory limited third-party insurance cover known as DPVAT (Danos Pessoais Causados por Veículos Automotores de Vias Terrestres) or Seguro Obrigatório (compulsory insurance), established by law in 1974.

Mexico: In 2013, Mexico passed an insurance law that implemented compulsory insurance coverage for vehicles in a gradual way. Insurance coverage became mandatory for all vehicles in Mexico in 2019, requiring a minimum of third-party liability coverage. This kind of insurance involves two components: (1) coverage for third party personal injury, with a minimum insured value of MXN100,000; and (2) coverage for third parties material losses (property damage), with a minimum insured value of MXN50,000.

Valuation

- ◆ We explain our blended valuation methodology, which is in line with the valuation approach used for banks in our coverage universe
- ◆ We arrive at target prices of BRL33.00 for Porto Seguro and MXN165.00 for Qualitas
- ◆ We illustrate the sensitivity of our target prices to various equity risk premiums and growth assumptions

Valuation methodology

Blended valuation technique

In line with the valuation approach we use for banks in our coverage universe, we value Porto Seguro and Qualitas using a combination of multi-period dividend discount model (50% weight), economic profit model (30%), and implied PE valuation (20%). Each of these methodologies are explained below.

Dividend discount model (DDM): The dividend discount valuation approach calculates the fair value of the company as the present value of its future dividends using the cost of equity as the discount rate. The dividends are based on our estimate of the dividend policy for each company. Our dividend discount valuation methodology consists of three stages: explicit (2024e-26e), semi-explicit (2027e-30e), and maturity (2031e to perpetuity). In the first stage, dividends are calculated based on our explicit forecasts of net income and payout ratio. In the second, dividends are calculated based on our semi-explicit forecasts. In the third, maturity stage, we assume a constant growth rate for earnings and a stable payout ratio for the company.

Economic profit model (EPM): The economic profit model approach calculates the fair value of a company at any point in time as the sum of its net worth at that point, and the present value of its future excess return over the cost of equity. Our economic profit valuation methodology consists of three stages: explicit (2024e-26e), semi-explicit (2027e-30e), and terminal (2031e-50e). In the first stage, excess income is calculated on our explicit three-year forecast. In the second stage, excess income is calculated on semi-explicit ROE and COE assumptions. We assume that returns converge to the cost of equity in the terminal stage.

Implied PE: We calculate a target PE multiple based on the formula $\text{ROE} \text{ less long-term growth (ROE-g) divided by ROE times cost of capital less long-term growth (k-g)}$. In essence, the PE equals the PBV derived from the Gordon growth model divided by ROE. We estimate the company's cost of equity and apply our 2024e ROE estimate to derive our target PE multiple.

Valuation and risks

Porto Seguro

We derive a fair value target price for Porto Seguro using a blended valuation approach of multi-period dividend discount model (50%), economic profit model (30%), and single-period implied PE (20%). We arrive at a cost of equity of 11.6% based on a risk-free rate of 3.5%, equity risk premium of 9.0%, inflation differential with the US of 1.5%, and beta of 0.78. We also assume a long-term growth rate of 6.5%. Our TP of BRL33.00 implies c11% upside and we initiate coverage of Porto Seguro with a Hold rating, as we expect earnings to face headwinds in the coming quarters from: (1) a slowdown in premium growth as the company nears completion of its tariff adjustments, and due to a modest growth in new vehicle sales trends; (2) lower financial income from investments as policy rates start to come down in Brazil. Large parts of Porto's operating income are derived from investment income; and (3) increased claim costs as the company plans to expand further into health insurance, which typically incurs higher costs.

Blended valuation

Valuation methodology	Weighting	Fair value (BRL)
DDM	50%	29.1
EPM	30%	32.6
Implied PE (2024e PE of 12.7x)	20%	45.6
Target Price (TP)		33.0

Source: HSBC

Upside risks:

- ◆ Faster than expected economic growth resulting in strong GDP and premium growth
- ◆ Smaller than expected rate cuts, which would be supportive of Porto's investment income
- ◆ Stronger than expected growth and earnings contribution from non-insurance verticals (Porto bank, Porto Serviço) and the health insurance segment.

Downside risks:

- ◆ Intense competition from major banks and other financial institutions could hinder the company's expansion into other insurance segments and credit business, thereby limiting the potential change in its revenue mix
- ◆ Unsuccessful expansion into competitive sectors like banking and healthcare insurance, where underperformance could risk the group's earnings
- ◆ Pressure on investment income as the easing cycle gains momentum. Faster-than-expected rate cuts could weigh on financial income and company earnings
- ◆ Faster growth in Health insurance may require the company to build larger reserves for claims due to the higher cost of medical services
- ◆ Higher individual loan delinquencies (in credit cards, vehicle loans, and personal loans) if the economy suffers a significant slowdown. A higher NPL ratio would require the company to increase its provisioning levels, thus potentially hurting profitability.

Qualitas

We derive a fair value target price for Qualitas using a blended valuation approach of multi-period dividend discount model (50%), economic profit model (30%), and single-period implied PE (20%). We arrive at a cost of equity of 10.2% based on a risk-free rate of 3.5%, equity risk premium of 6.5%, additional equity risk premium of 100bps (to incorporate the higher policy risk in Mexico after the ruling Morena party gained an unexpectedly large supermajority in Congress, which would allow it to approve the constitutional changes that outgoing president AMLO proposed earlier in the year), inflation differential with the US of 1.5%, and beta of 0.74. We also assume a long-term growth rate of 6.0%.

Our resulting TP of MXN165 implies c9% downside. We initiate coverage with a Reduce rating as valuation metrics look rich after strong stock performance in the last 13 years, and an increase in country risk. Additionally, the company faces a risk from a tax-related contingency. However, we remain confident in Qualitas's future growth prospects, its ability to generate high sustainable ROEs, and potential to pay higher dividends in coming years given the company's strong capital position (solvency ratio was 336% as of 1Q 2024).

Blended valuation

Valuation methodology	Weighting	Fair value (MXN)
DDM	50%	169.9
EPM	30%	164.3
Implied PE (2024e PE of 16.2x)	20%	155.1
Target Price (TP)		165.0

Source: HSBC

Upside risks:

- ◆ Faster than expected economic growth resulting in strong GDP and premium growth.
- ◆ Delayed rate cuts in Mexico to be supportive of investment income of the company.
- ◆ Faster growth in Qualitas Salud, its health insurance business that adds upside risk to our estimates.

Target price sensitivity analysis to growth and ERP

In the table below, we illustrate the sensitivity of our target prices to various levels of equity risk premium and growth assumptions.

Porto Seguro

Our valuation approach assumes an equity risk premium for Brazil of 9.0%, which along with risk-free rate of 3.5%, inflation differential with the US of 1.5%, and beta of 0.78 results in a cost of equity of 11.6%.

Porto Seguro: Sensitivity of target price to changes in risk premium and growth assumptions

		Stable growth						
		5.0%	5.5%	6.0%	6.5%	7.0%	7.5%	8.0%
ERP	7.5%	36	37	39	41	43	46	50
	8.0%	34	35	36	38	40	42	45
	8.5%	32	33	34	36	37	39	41
	9.0%	31	31	32	33	35	36	38
	9.5%	29	30	31	32	33	34	36
	10.0%	28	28	29	30	31	32	33

Source: Company data, HSBC estimates

Qualitas

Our valuation approach assumes an equity risk premium (ERP) for Mexico of 6.5% and additional risk premium of 1.0%, which along with a risk-free rate of 3.5%, inflation differential with the US of 1.5%, and beta of 0.74 results in a cost of equity assumption of 10.2%. We also assume terminal growth of 6.0%.

Qualitas: Sensitivity of target price to changes in risk premium and growth assumptions

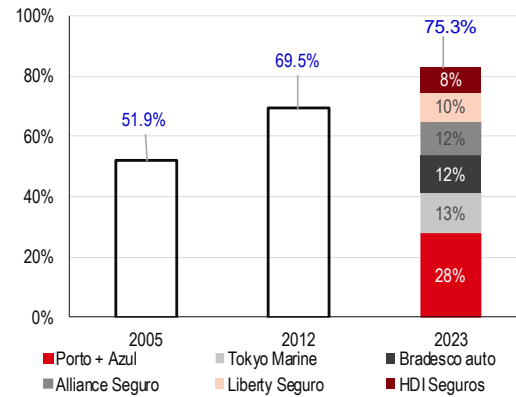
		Stable growth						
		4.5%	5.0%	5.5%	6.0%	6.5%	7.0%	7.5%
ERP	6.5%	165	172	181	191	203	220	242
	7.0%	156	162	169	177	187	200	216
	7.5%	148	153	158	165	173	184	196
	8.0%	140	144	149	155	162	170	180
	8.5%	133	137	141	146	152	158	167
	9.0%	127	130	134	138	143	149	155

Source: Company data, HSBC estimates

Company profiles

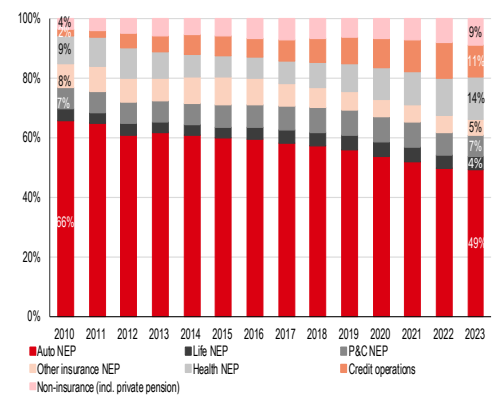
Porto Seguro: Investment thesis in charts

Porto is Brazil's leading underwriter in the auto, residential, and commercial P&C insurance segments



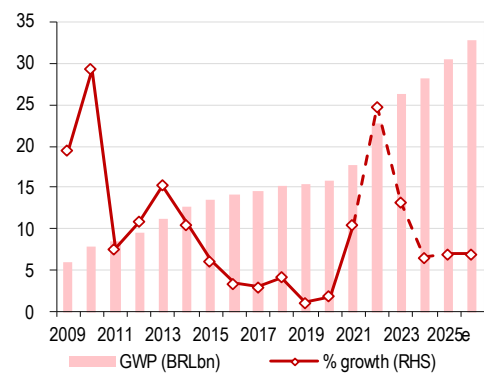
Source: SUSEP; *Auto GWP market share

Over the years, the company has diversified its revenues base from auto to health insurance and credit operations



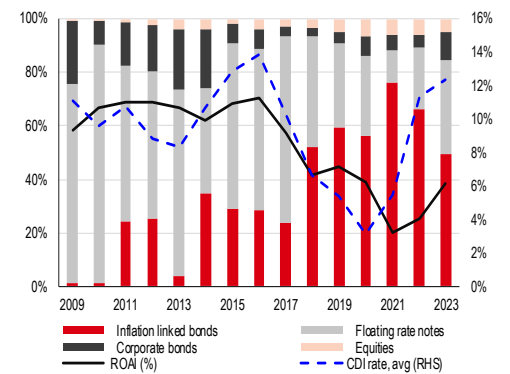
Source: Company data

Yet, earnings will face hurdles from a slowdown in premium growth as Porto nears completion of tariff adjustments...



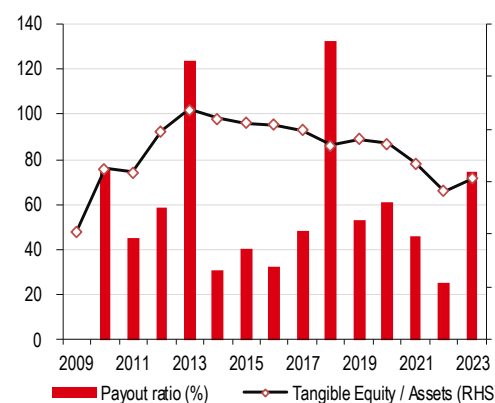
Source: Company data; HSBCe

... and lower policy rates in Brazil exert pressure on investment income



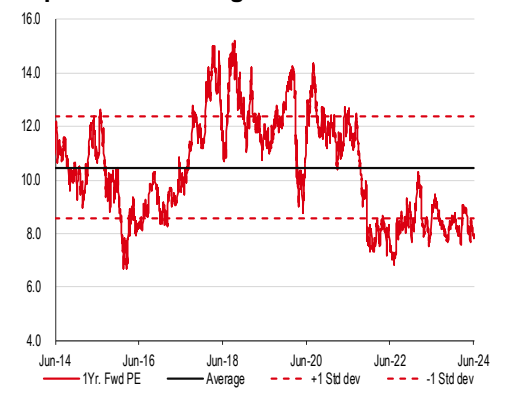
Source: Company data

Capital is adequate



Source: Company data

The stock trades at a 1-yr fwd PE of 7.9x vs a 10-yr avg of 10.4x, but expansion depends on earnings acceleration



Source: Refinitiv Datastream

Porto Seguro

- ◆ Porto Seguro is a leading insurer in Brazil's auto (28% market share), residential (22%), and commercial P&C insurance (25%) segments
- ◆ Earnings face near-term headwinds from lower growth and falling interest rates; we forecast a 2023-26e earnings CAGR of 4%
- ◆ We initiate coverage with a Hold rating and TP of BRL33

Investment Positives

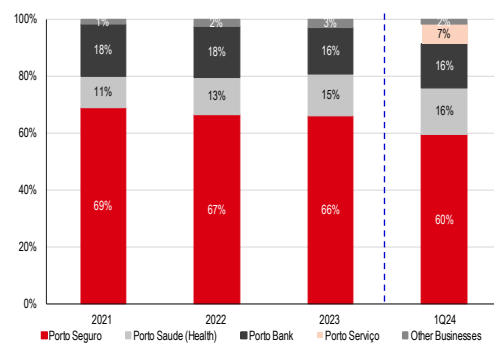
Leading insurer in auto, residential and P&C insurance markets

Porto is the leading underwriter in Brazil's auto (28% market share), residential (22% market share), and commercial P&C insurance (24.6% market share) segments.

Diversified revenue streams

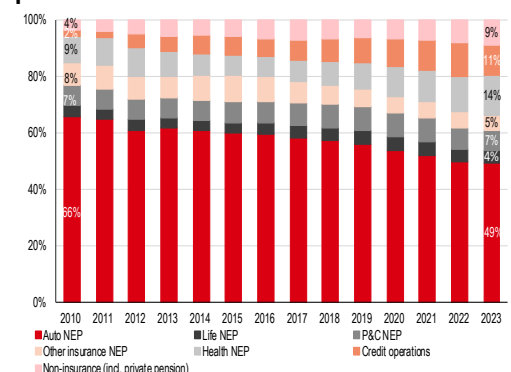
Porto segregates its revenue structure majorly into four business verticals: (1) Porto Seguro (Auto, P&C and Life insurance); (2) Porto Saude (Health & Dental insurance); (3) Porto Bank (credit card & financing, consortium & landlord guarantees); and (4) Porto Serviço (focused mainly on residential, business, and automotive assistance. The company started reporting this vertical from 1Q 2024). Its insurance products mainly include auto, its core market (49% of total revenues), health (14% of total revenues), P&C (industrial and commercial properties, 7% of total revenues), and life (4% of total revenues). Other non-insurance products mostly include credit operations, comprised of credit card offerings and auto loans (11% of total revenues), and services (9% of total revenues). The company aims to expand its presence in health insurance, financial services, including credit cards and digital accounts, and expand its services division (mainly residential, business, and automotive assistance). Although the non-insurance products currently represent only c20% of total revenues, their impact has been noticeable largely in terms of accelerating revenue growth, fostering customer engagement, and has provided cross selling opportunities within its client base. Porto's 2010-23 CAGR for insurance net earned premium (NEP) was c10% vs 26% for the credit operations and 19% for other non-insurance ventures.

Porto Seguro: Revenue diversification by business vertical



Source: Company data; from 1Q 2024, Porto started reporting Porto Serviço, its new vertical that offers a portfolio of residential, business and automotive assistance services

Porto Seguro: Revenue diversification by product *



Source: Company data; *as per accounting information under IFRS-4; NEP= Net Earned premium

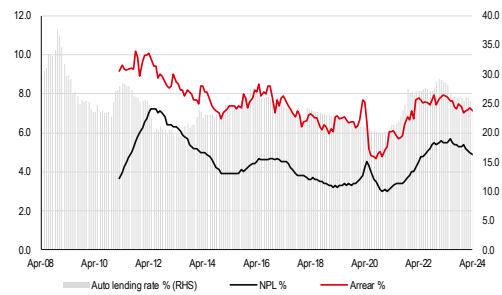
Partnership with Itau.

In 2009, Porto Seguro entered a strategic partnership with Itau Unibanco, the largest private bank in Brazil by assets. Through this partnership, Porto Seguro acquired Itau’s auto and residential insurance portfolio in exchange for a 43% stake in PSIUPAR, Porto Seguro’s holding company. This strategic alliance allowed Porto to gain access to Itau’s client base, which predominantly consists of mid- to high-income individuals. The partnership also provides Porto access to Itau’s extensive sales and distribution channels across Brazil, which allows the company to expand its reach and tap into new markets and regions.

Credit business: Asset quality cycle turned.

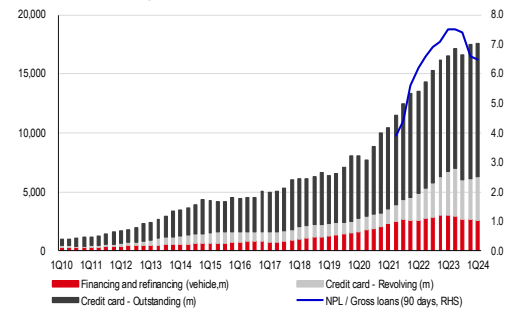
In the last few quarters, asset quality deterioration in the banking sector in Brazil, especially for the individual segment, emerged as a key concern. Notably, banks like Bradesco and Santander Brasil experienced a significant deterioration in their NPL ratios. Porto Seguro’s loan book encountered similar challenges, leading to an increased NPL ratio. However, the recent data from BCB, the Brazilian banking regulator, shows that asset quality has turned and delinquencies have peaked for the sector. Porto Seguro managed the cycle well, and in line with sector trends, the company’s NPLs have started to decline, suggesting a potential resurgence in growth trajectory.

Banking system: Asset quality and lending rates (%)



Source: BCB

Porto Seguro: Loan portfolio (BRLm) and asset quality (%)



Source: Company data

New CEO: Bringing a wealth of experience.

CEO Paulo Kakinoff was appointed in January 2024, succeeding Roberto Santos who became a board member. With nearly 25 years of experience in the automotive and aviation sectors, Mr Kakinoff brings a wealth of knowledge to this role. Previously he served for 10 years (from July 2012 to July 2022) as CEO of GOL, a Brazilian airline, and also held an executive position at Volkswagen (CEO of Audi Brasil until 2012) and worked in the automotive industry for 18 years. Currently, he is also a director on the boards of directors of several companies in various sectors, showcasing his extensive expertise and leadership capabilities.

Easing credit environment could enhance new vehicle sales in Brazil

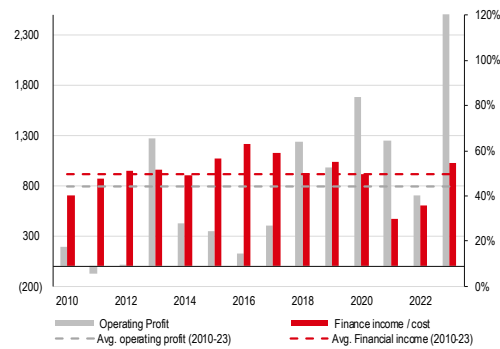
After experiencing very high interest rates and a challenging asset quality cycle in 2023, especially in the retail segment, the Brazilian banks opted for a cautious stance towards loan origination, leading to a significant slowdown in credit growth (system loans grew 8.8% in 2023 vs 14.0% in 2022). In line with this trend, auto financing also slowed, resulting in lower vehicle sales. However, as we look ahead to 2024 and beyond, with declining inflation and easing interest rates, we expect to see a gradual pick-up in total loan growth. This positive trajectory should enhance consumer purchasing power and fuel growth in vehicle sales. Individual debt (principal + interest) as a percentage of disposable income was at 25.7% in Feb 2024 vs 28.4% in Jun 2023. The easing of consumer leverage in Brazil may allow the banks to increase credit growth, and that may result in increased vehicle sales and auto premium growth in Brazil.

Investment concerns

Lower rates a headwind to investment income

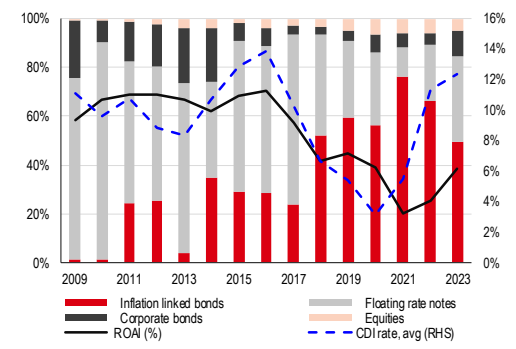
A large part of Porto Seguro's earnings is derived from its investment portfolio, which is mostly allocated on fixed income securities (inflation linked and floating rates note). As shown in the chart below, the average underwriting profit for the company in the last 13 years has been lower than the average financial income from the investment portfolio (59% of Porto Seguro's 2010-13 average PBT was from financial income). We believe that the expected easing cycle will likely put pressure on the investment income and earnings of the company in the coming years. Porto will likely have to change the mix of its investment portfolio to counter the prospect of lower rates in Brazil. HSBC economists expect the policy rate to end 2024e at 10.5% and 2025e at 10.0%. Our sensitivity analysis suggests that every 100bps decline in EOP Selic rate from our base case assumption could lower 2024-25e financial income by 8-17% and earnings by 3-5% ([page 30](#)).

Porto Seguro: Operating profit and financial income



Source: Company data

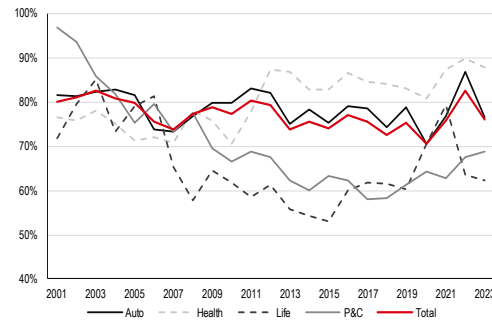
Porto Seguro: Investment portfolio composition and ROAI



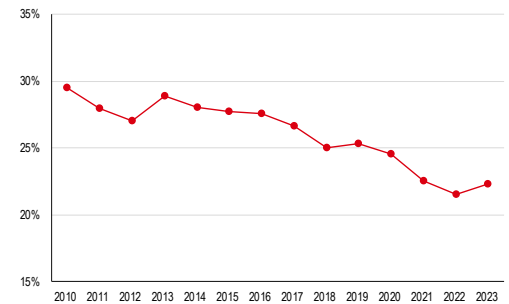
Source: Company data

Revenue diversification bringing limited benefits so far; increased leverage.

Over the last 10 years, Porto Seguro has been striving to diversify its product offerings from auto insurance to other insurance lines (health, life, P&C) and into non-insurance products (credit and services) by leveraging cross-selling opportunities with its large auto insurance client base. Non-insurance revenues currently account for only c20% of total revenues. Over the years, consolidated claim and acquisition costs have also remained largely unchanged for the company. While diversifications efforts have yielded slightly better results in terms of revenue growth (total revenues grew at a 2017-23 CAGR of 12% vs NEP growth of 10%) and increased customer engagement, there have been very limited benefits so far in terms of costs or earnings growth, in our view. Porto also introduced higher leverage into its financial structure as the company diversified its portfolio to include credit services. The equity to assets ratio declined from 29% in 2013 to 22% in 2023.

Porto Seguro: Loss + acquisition expense ratio


Source: Company data; Loss + selling expense ratio = (loss expenses + selling expense) / Net earned premium

Porto Seguro: Equity to assets ratio


Source: Company data

Earnings risk from expansion in competitive sectors like banking and health insurance

In recent years, Porto has worked on expanding its revenue sources. It has diversified from auto insurance to health (14% of total revenues), P&C (7% of total revenues), life (4% of total revenues), and other non-insurance products, including credit operations (11% of total revenues) and other services. However, we believe the company's expansion into competitive sectors like banking and healthcare insurance may pose a risk to its earnings if it underperforms. Additionally, faster growth in health insurance may require the company to set aside more funds for claims due to the higher cost of medical services, and may result in higher claim ratio, which could negatively impact its overall earnings. A resurgence in NPLs may require higher provisions in the banking segment, in our view.

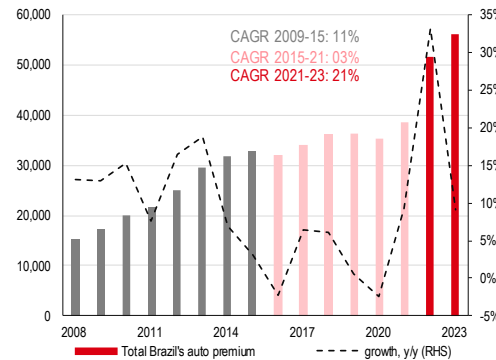
Still low penetration in Brazil but transitioning towards maturity

Although we acknowledge the fact that insurance penetration in Brazil remains low (at c4.0%) compared to developed and some emerging economies, it is important to note that it is gradually reaching closer to some of the advanced economies like Spain (at 4.8%), Portugal (at 4.7%), Germany (at 5.9%), and EM countries like Malaysia (at 5.3%), and Thailand (at 5.9%). Looking ahead, we believe that while there is still room for the insurance sector to grow, the pace of growth is likely to be modest, with growth prospectus appearing less captivating than in countries like Mexico and India.

Economic deceleration hurts volume growth, and pricing power; recent growth mostly driven by tariff adjustments

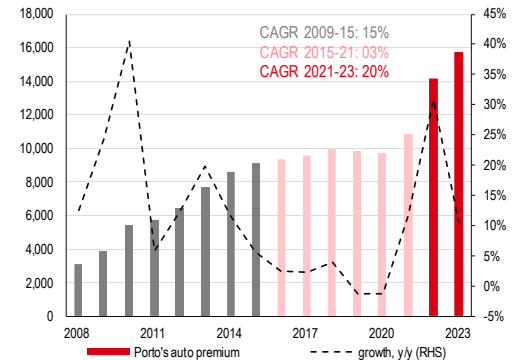
The economic cycle significantly impacts the auto insurance industry. In Brazil, despite facing challenges such as macro uncertainties, the COVID-19 pandemic, and global political issues, the auto insurance market has displayed resilience and growth over the past decade. From 2009 to 2015, the total auto insurance gross written premiums (GWP) CAGR was c11% during a period of rapid economic growth in Brazil. However, from 2015 to 2021, the CAGR was only c3% as Brazil's economy contracted. In 2022 and 2023, auto insurance companies experienced significant growth after a period of weak expansion during the pandemic. This growth was partially due to pricing adjustments in response to increased vehicle prices, improved economic activity, higher claims resulting from increased inflation rates, and supply chain constraints. Economies in Latin America are already slowing in response to current higher rates, and any additional challenges to economic activity could lead to a slowdown in vehicle sales and a decrease in the top-line growth of auto insurance companies, in our view.

Auto sector premium (BRLm) and growth (%)



Source: Company data

Porto Seguro auto (BRLm) and growth (%)

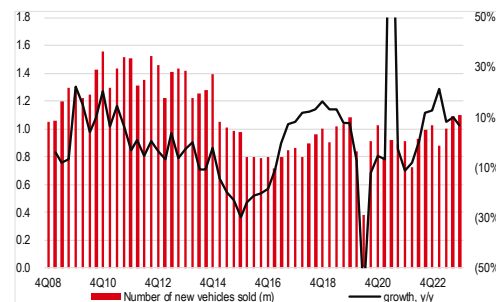


Source: Company data

Slowdown in vehicle growth rate could lead to lower premium growth.

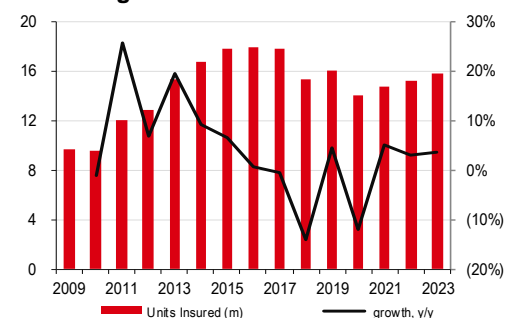
In the last few years, Brazil has experienced a slowdown in the growth of new vehicle sales, mainly driven by sluggish economic environment. Consequently, Porto Seguro and the auto insurance sectors have seen a slowdown in numbers of unit insured. With a further slowdown in vehicle sales, the prospects for auto insurance premiums could be negatively impacted.

Brazil: Number of new vehicles sold



Source: B3, Cetip; the Brazilian Association of Automotive Vehicle Manufacturers (ANFAVEA)

Porto Seguro: Units insured



Source: Company data

Dependence on agents for distribution

In Brazil, insurance companies are bound by regulations that mandate the sale of insurance products primarily through agents, making this a distinctive characteristic of the Brazilian insurance industry. Moreover, companies themselves tend to prefer this approach as customers favor the personalized interaction facilitated by agents, have lower awareness about the insurance products, and the products tend to be complex. For Porto Seguro, 97% of its auto insurance and a large portion of other insurance products are sold through agents, while the remaining through branch network and online channels. Although this structure allows companies to control customer acquisition costs at a 20-30% commission rate to agents, it also results in heavy dependence on agents for products sales.

Corporate governance

Historically, governance issues have been particularly relevant for financial companies in the LatAm region. Many banks and insurance companies are still controlled by families or parent companies whose interests may not be aligned with those of minority shareholders. For Porto Seguro, the Garfinkel family is the controlling shareholder with a 57% stake in PSIUPAR, Porto Seguro's holding company, while Itau Unibanco holds the remaining 43% stake in PSIUPAR. We think another good way of assessing the level of governance risk is by analyzing its board

strength, particularly focusing on the proportion of independent directors. Porto's board is composed of 7 members (vs c10 or above for other financial institutions), a positive for decision making, but only 43% (3 members) are independent. On the positive side, it's important to note that unlike some financial institutions that have multiple share classes with different economic and voting rights, Porto only has one share class with equal voting shares. Each share carries one vote and gives minority shareholders 100% tag-along rights if a change of control occurs. The company's share capital is divided into 646m common shares. More ESG details on [pg60](#).

Earnings sensitivity to policy rates

We present below potential sensitivity of Porto Seguro's earnings to an expedited cut in Selic rate in Brazil. Our analysis suggests that for every 100bps decline in the EOP Selic rate from our base case assumptions for 2024-25e, Porto's financial income could be negatively impacted by 8-17% and earnings by 3-5%.

Sensitivity to policy rate

BRLm	2023	2024e	2025e
Current assumptions			
SELIC rate, eop	11.75%	10.50%	10.00%
SELIC rate, avg	12.75%	11.13%	10.25%
CDI rate, avg	12.40%	11.13%	10.25%
Financial income	1,028	1,102	1,108
Net income	2,266	2,334	2,451
EPS	3.50	3.60	3.78
Shareholder's equity	12,235	13,322	14,490
ROAE	19.9%	18.3%	17.6%
Assuming: -100bp for each year			
SELIC rate, eop	11.75%	9.50%	9.00%
SELIC rate, avg	12.75%	10.63%	9.25%
CDI rate, avg	12.4%	10.6%	9.3%
Financial income	1,028	1,012	922
Net income	2,266	2,274	2,327
EPS	3.50	3.51	3.59
Shareholder's equity	12,235	13,262	14,338
ROAE	19.9%	17.8%	16.9%
% change			
Financial income		(8.2%)	(16.8%)
Net income		(2.5%)	(5.1%)
ROAE (p.p)		(0.42)	(0.77)

Source: Company data, HSBC

Porto Seguro: Forecast drivers

- ◆ **Premium growth:** Over the past two years, premium growth in the Brazil's auto insurance sector has remained relatively resilient, mostly driven by tariff increases and a modest recovery in new vehicle sale. We expect premium growth to soften in 2024e as the company nears completion of its pricing adjustments. We forecast GWP growth of 7.5% in 2024e and 8% in the long run.
- ◆ **Underwriting performance:** Following the pandemic, Porto Seguro experienced a surge in loss ratio throughout 2022, largely attributed to higher inflation rate. However, the company started to see sign of normalization by 2023, making a gradual return to pre-pandemic levels. Looking ahead to 2024, we anticipate a slight improvement in loss ratio as inflationary pressure eases, albeit partially offset by higher growth in the health business, which typically incurs higher costs. We don't expect much change in acquisition and operating ratios, and forecast levels that the company is likely to maintain over the coming years as Porto's business model heavily depends on a network of external agents for product distribution.
- ◆ **Financial income:** The last three years have been challenging for Porto Seguro's financial results, with a negative spread over benchmark CDI rate. This can be attributed to a large portion of the portfolio being allocated to inflation-linked bonds. We believe that the easing cycle will likely put pressure on the investment income and earnings of the company in the coming years. HSBC economists expect the policy rate to end 2024e at 10.5% and 2025e at 10%. We expect investment income to be negatively impacted if interest rates stabilize at much lower levels than the current double-digit rates.
- ◆ **Dividends:** According to its bylaws, Porto Seguro must distribute at least 25% of its adjusted net income as a mandatory dividend. Adjusted net income is calculated as net income for the year net of: (i) the values allocated to legal and contingency reserves, increased by (ii) the reversal of the provision for contingencies. Historically, Porto has paid out an average dividend of 60% of net income (2010-23 average). We forecast the dividend payout will remain in line with this historical average over the medium to long term.

2024 guidance

We highlight the fact that the company has improved its disclosure practices in the last few years by providing a detailed breakdown of its four verticals, which aids in comprehensive analysis. It also provided 2024 guidance for each vertical in 1Q 2024.

2024 guidance

Business Unit	Range
Porto Seguro	
Earned Premium Growth	+5% to +10%
Loss Ratio	50% to 54%
G&A Ratio	10.5% to 11.5%
Porto Saúde	
Earned Premium Growth	+40% to +50%
Loss Ratio	77% to 82%
G&A Ratio	5.1% to 6.1%
Porto Bank	
Total Revenue Growth	+13% to +19%
Credit Losses	BRL1.75bn to BRL2.05bn
Efficiency Ratio	31.0% to 35.0%
Porto Serviço	
Total Revenue	BRL2.4bn to BRL2.7bn
G&A Ratio	8.0% to 9.0%
Consolidated	
Financial Result	BRL0.85bn to BRL1.0bn
Effective Rate	30.0% to 36.0%

Source: Company

Introducing our estimates

Our 2024e-26e EPS forecasts are largely in line with Visible Alpha consensus. We expect 3% y-o-y EPS growth in 2024e, followed by 5% growth in 2025e and 4% growth in 2026e. We have modest 2023-30e EPS CAGR projections of 6%.

HSBCe vs consensus				Key assumptions			
BRLm	2024e	2025e	2026e	%	2024e	2025e	2026e
HSBC net profit	2,334	2,451	2,556	GWP growth, y/y	7.5	8.0	8.0
Net profit consensus	2,364	2,557	2,698	Claims ratio (on NEP)	55.5	56.0	55.9
HSBC vs consensus	(1%)	(4%)	(5%)	Acquisition ratio (on NEP)	20.0	20.0	20.0
HSBC EPS (BRL)	3.60	3.78	3.95	Admin exp. Ratio (on NEP)	13.0	13.0	13.0
EPS consensus (BRL)	3.56	3.83	3.97	Combined ratio (on NEP)	93.5	94.0	93.9
HSBC vs consensus	1%	(1%)	(1%)	ROAI	6.1	6.0	5.9
				Effective tax rate	34.0	33.0	33.0

Source: Visible alpha, HSBC estimates

Porto Seguro: Annual summary (BRLm)

Income Statement	2019	2020	2021	2022	2023	2024e	2025e	2026e	CAGR 11-23a	CAGR 23-26e
Gross Written Premium (GWP)	15,470	15,805	17,712	22,729	26,186	28,150	30,402	32,834	10%	8%
Net Earned Premiums (NEP)	14,907	14,975	16,206	19,841	24,745	26,742	28,578	30,535	10%	7%
Income from credit operations	1,577	1,709	2,119	2,943	3,316	3,809	4,472	5,039	26%	15%
Non-insurance revenues	1,063	1,229	1,383	1,973	2,771	3,602	4,142	4,557	19%	18%
Total Revenues	17,546	17,913	19,709	24,758	30,832	34,153	37,192	40,131	11%	9%
Insurance Claims	(7,925)	(7,121)	(8,612)	(12,215)	(13,905)	(14,849)	(16,012)	(17,079)	9%	7%
Acquisition Costs	(3,522)	(3,752)	(4,049)	(4,542)	(5,406)	(5,941)	(6,405)	(6,875)	10%	8%
Net Operating Expenses	(3,088)	(3,159)	(3,602)	(3,883)	(4,662)	(5,700)	(6,299)	(6,896)	8%	14%
Total Expenses	(16,558)	(16,229)	(18,462)	(24,050)	(28,316)	(31,659)	(34,582)	(37,453)	10%	10%
Operating Profit	988	1,684	1,247	707	2,516	2,494	2,611	2,678	na	2%
Finance Income / Cost	1,039	921	469	604	1,028	1,102	1,108	1,182	1%	5%
Profit Before Tax	2,027	2,605	1,716	1,312	3,544	3,596	3,718	3,860	13%	3%
Tax Expenses	(648)	(917)	(171)	(160)	(1,229)	(1,223)	(1,227)	(1,274)	16%	1%
Profit After Tax	1,379	1,688	1,544	1,152	2,315	2,374	2,491	2,586	12%	4%
Minorities	(0)	(0)	(0)	(21)	(49)	(40)	(40)	(30)	70%	(15%)
Net Profit	1,379	1,688	1,544	1,131	2,266	2,334	2,451	2,556	12%	4%
Diluted EPS	2.13	2.60	2.40	1.76	3.50	3.60	3.78	3.95	12%	4%
% growth	5%	22%	(8%)	(27%)	99%	3%	5%	4%		
Diluted EPS, recurring	2.13	2.60	2.40	1.76	3.50	3.60	3.78	3.95	12%	4%
% growth	5%	22%	(8%)	(27%)	99%	3%	5%	4%		
BV per share	12.8	13.9	14.5	16.3	18.9	20.6	22.4	23.7	8%	8%
TBV per share	9.6	10.6	10.8	10.7	13.0	14.7	16.5	17.8	10%	11%
Ratios (%)	2019	2020	2021	2022	2023	2024e	2025e	2026e	Avg. 11-23a	Avg. 23-26e
Balance sheet										
Securities / Assets (%)	42.6	41.4	32.5	28.0	33.0	29.7	28.7	28.3	39.2	29.9
Receivables as % assets	14.0	15.3	17.3	16.1	17.0	17.5	16.2	15.7	12.4	16.6
Loan / Assets (%)	18.6	20.0	22.3	24.1	24.1	27.7	31.3	33.5	19.5	29.2
Technical reserves / Assets (%)	44.7	42.5	39.5	39.5	38.9	38.7	38.9	38.7	43.7	38.8
Investments / technical reserves (%)	95.3	97.4	82.5	71.0	84.7	76.8	73.8	72.9	89.6	77.1
Written premium										
Total GWP growth (y/y)	1.3	2.2	12.1	28.3	15.2	7.5	8.0	8.0	9.9	9.7
Total NEP growth (y/y)	1.8	0.5	8.2	22.4	24.7	8.1	6.9	6.9	10.1	11.6
GWP / Assets (%)	47.3	43.0	42.5	46.2	47.7	47.2	46.3	45.6	50.6	46.7
Technical reserves / GWP (%)	94.6	98.8	92.8	85.5	81.5	82.0	84.0	85.0	86.8	83.1
Financial income										
Financial income growth (y/y)	12.2	(11.4)	(49.1)	28.9	70.1	7.2	0.5	6.7	6.5	21.1
ROAI (Return on investments)	7.2	6.3	3.2	4.0	6.1	6.1	6.0	5.9	8.3	6.0
% of CDI rate	133	199	58	35	49	55	58	74	98.4	59.1
Cost										
Claims ratio	53.0	47.5	53.1	61.6	56.2	55.5	56.0	55.9	55.2	55.9
Acquisition ratio	22.4	23.2	22.8	21.1	19.9	20.0	20.0	20.0	21.1	20.0
Admin exp. ratio	14.0	13.8	14.3	11.9	11.4	13.0	13.0	13.0	14.4	12.6
Combined ratio (extended)	89.4	84.5	90.2	94.6	87.5	88.5	89.0	88.9	90.7	88.5
Combined ratio	94.4	89.9	94.7	98.1	91.4	93.5	94.0	93.9	95.0	93.2
Cost / income (consolidated)	94.4	90.6	93.7	97.1	91.8	92.7	93.0	93.3	95.5	92.7
Cost growth, y/y (insurance)	6.9	(4.3)	14.0	26.8	16.2	10.5	7.4	6.7	9.8	10.2
Cost growth, y/y (consolidated)	6.0	(2.0)	13.8	30.3	17.7	11.8	9.2	8.3	11.0	11.8
Capitalization										
Solvency margins	158	167	135	127	146	150	151	150	151.5	149.1
Tangible equity / Assets	19.1	18.6	16.8	14.1	15.3	15.9	16.3	16.0	18.6	15.9
Equity / Assets	25.3	24.5	22.5	21.5	22.3	22.3	22.1	21.3	25.8	22.0
Div. payout	52.6	61.2	45.7	25.3	74.1	55.0	55.0	70.0	58.0	52.0
Profitability										
Effective tax rate	32.0	35.2	10.0	12.2	34.7	34.0	33.0	33.0	29.3	33.7
Operating margins (OI / NWP)	6.4	10.8	7.1	3.1	9.7	8.9	8.6	8.2	5.0	8.9
Net margins (NI / NWP)	9.0	10.8	8.8	5.0	8.7	8.3	8.1	7.8	8.1	8.3
ROAA, recurring	4.4	4.9	3.9	2.5	4.4	4.1	3.9	3.7	4.28	4.02
ROAE, recurring	17.3	19.5	16.8	11.3	19.9	18.3	17.6	17.1	16.44	18.23
Balance Sheet	2019	2020	2021	2022	2023	2024e	2025e	2026e	CAGR 11-23a	CAGR 23-26e
Cash & due from banks	893	916	1,401	2,434	1,105	1,397	1,510	1,631	(3%)	14%
Securities	13,942	15,207	13,550	13,786	18,094	17,734	18,849	20,357	9%	4%
Accounts receivable	4,572	5,636	7,195	7,925	9,304	10,415	10,641	11,328	20%	7%
Intangibles	2,037	2,156	2,379	3,643	3,817	3,817	3,817	3,817	5%	0%
Total Assets	32,711	36,730	41,629	49,187	54,852	59,683	65,604	72,028	10%	10%
Technical reserves	14,636	15,615	16,430	19,423	21,352	23,083	25,537	27,909	10%	9%
Other liabilities	9,806	12,111	15,835	19,123	21,183	23,191	25,486	28,693	13%	11%
Equity	8,270	9,004	9,365	10,583	12,235	13,322	14,490	15,330	8%	8%
Securities Growth	0%	9%	(11%)	2%	31%	(2%)	6%	8%	6%	9%
Technical Reserve Growth	2%	7%	5%	18%	10%	8%	11%	9%	10%	12%
Equity Growth	8%	9%	4%	13%	16%	9%	9%	6%	8%	12%
Payout Ratio	53%	61%	46%	25%	74%	55%	55%	70%	58%	52%

Source: Company data; HSBCe

1Q 2024 results: Off to a good start

- ◆ Porto Seguro delivered a strong 1Q 2024 outcome, with ROAE of c21.4%; the results were driven by healthy top-line growth, marginal improvement in loss ratio & admin expenses, partially offset by lower financial income and a higher tax rate.
- ◆ In the Insurance vertical, premiums grew 6.6% y/y, mainly driven by P&C (+12.5%) and Life (+12.0%) segments, while the auto segment reported growth of c5% y/y vs 2% in 4Q 2023. The insurance vertical's combined ratio improved 4.3 p.p. y/y to 88.9% in, mainly explained by the reduction in the auto claims ratio (by 5.3 p.p y/y)
- ◆ In the Health Insurance vertical (Porto Saúde), premiums continued to grow at a faster pace of 49% y/y, in line with the company's strategy to grow more quickly. The combined ratio improved by 6.6 p.p y/y to 88.0%
- ◆ Porto Bank's total revenues grew 21.0% y/y, mainly driven by 38.7% growth in Consortium revenues. ROE was 27% vs 13% in 2023. The credit portfolio grew 6% y/y, reaching BRL17.6bn, while asset quality continued to show improving trends (NPL ratio improved 10bps sequentially to 6.5%).
- ◆ From 1Q 2024 onwards, Porto started reporting the results of Porto Servico, its new vertical resulting from the spin-off of the assistance operation from the insurance segment and the acquisition of CDF (largest B2B2C marketplace in Brazil). Total revenues for the vertical were BRL612m, with EBITDA margin of 18.4% and ROE of 21%
- ◆ During the quarter, the company also disclosed 2024e guidance for each vertical, and provided guidance related to the financial results and the effective tax rate for the consolidated group ([page 31](#)).

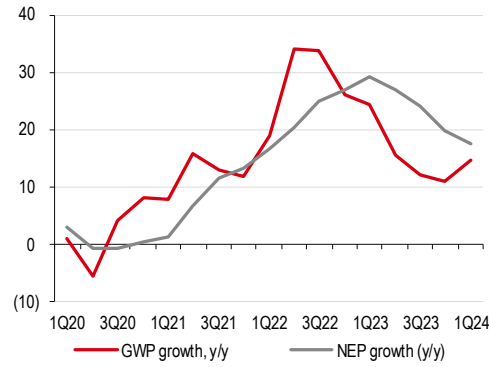
1Q 2024 results summary

BRLm	1Q23	2Q23	3Q23	4Q23	1Q24	Q-on-Q	Y-on-Y
Securities	16,004	15,964	15,107	18,094	17,735	(2%)	11%
Securities Growth	18%	17%	8%	31%	11%	(20.4pp)	(7.3pp)
Technical Reserves	19,831	20,045	20,668	21,352	21,525	1%	9%
Technical Reserve Growth	18%	14%	10%	10%	9%	(1.4pp)	(9.0pp)
Equity	10,877	11,459	11,858	12,235	12,325	1%	13%
Gross Written Premium (GWP)	5,972	6,272	6,954	6,989	6,841	(2%)	15%
Net Earned Premiums (NEP)	5,736	6,000	6,407	6,601	6,745	2%	18%
Total Expense	(6,797)	(6,825)	(7,178)	(7,517)	(7,585)	1%	12%
Operating Profit	413	687	731	685	787	15%	90%
Finance Income / Cost	170	276	248	333	258	(23%)	51%
Profit before tax	584	963	979	1,018	1,044	3%	79%
Net income, recurring	333	706	579	649	658	1%	98%
Extraordinary items	0	0	0	0	0		
Net income, reported	333	706	579	649	658	1%	98%
Diluted EPS, recurring (in BRL)	0.51	1.09	0.89	1.00	1.02	1%	98%
Diluted EPS (in BRL)	0.51	1.09	0.89	1.00	1.02	1%	98%
BVPS (in BRL)	16.8	17.7	18.3	18.9	19.0	1%	13%
Total GWP growth (y/y, %)	24.5	15.6	12.1	10.8	14.6	3.72	(9.93)
Claims ratio %	59.5	54.9	54.2	56.4	55.2	(1.17)	(4.35)
Acquisition ratio %	20.0	19.9	19.5	20.3	20.0	(0.27)	(0.06)
Admin exp. ratio %	11.5	11.1	10.7	12.2	10.6	(1.63)	(0.88)
Combined ratio %	91.1	85.8	84.3	88.8	85.8	(3.07)	(5.29)
ROAI (Return on investments %)	4.3	6.7	5.9	8.0	5.6	(2.46)	1.29
Effective tax rate %	28.0	14.7	(4.8)	12.5	40.7	28.17	12.74
ROAE, recurring %	12.4	25.3	19.9	21.5	21.4	(0.11)	9.03
Solvency margins %	138	132	141	146	151	5.11	13.35
Tangible equity / Assets %	14.4	14.9	15.1	15.3	15.4	0.04	0.96

Source: Company data

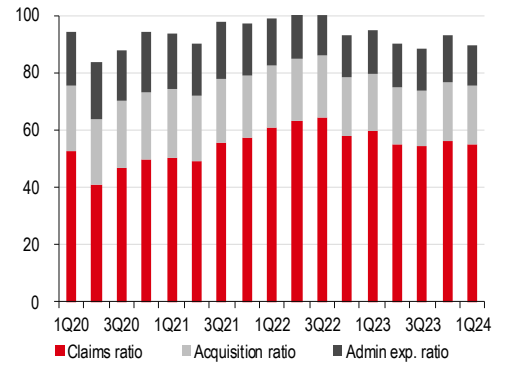
Porto Seguro: Quarterly charts

Premium growth (%)



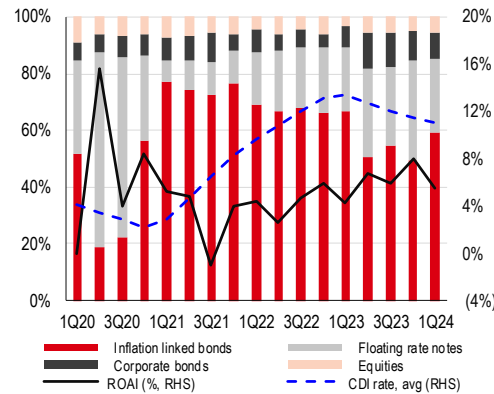
Source: Company data

Combined ratio (%)



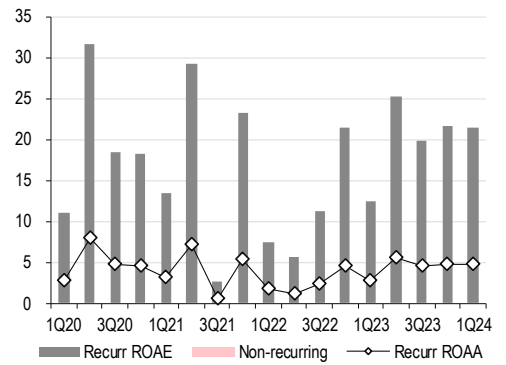
Source: Company data

Investment composition, ROAI and reference rate



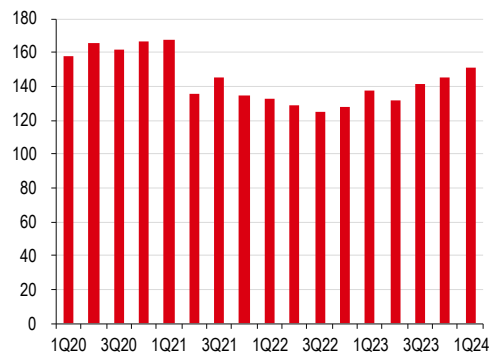
Source: Company data

Profitability indicators (%)



Source: Company data

Solvency margin (%)



Source: Company data

Overview of Porto Seguro

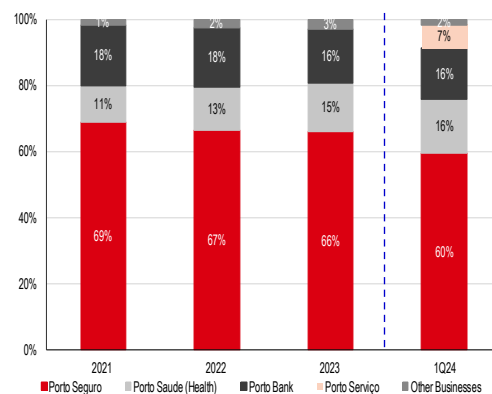
Introduction to the company

Porto Seguro is the third largest insurance company in Brazil by volume of premiums issued, and the largest non-life insurance group in Brazil with total gross written premiums of BRL26.2bn in 2023. Porto is the leading underwriter in the auto (28% market share), residential (22% market share), and commercial P&C insurance (24.6% market share) segments, while it also offers life (3% market share), health (1.4% share), and other P&C insurance. The company operates with four business verticals: (1) Porto Seguro (Auto, P&C and Life insurance); (2) Porto Saude (Health & Dental); (3) Porto Bank (credit card & financing), Consortium & Landlord Guarantees); and (4) Porto Serviço (focused mainly on residential, business, and automotive assistance; started reporting from 1Q 2024).

Porto Seguro offers its insurance products and services mostly through three key brands: (1) **Porto Seguro** – a premium brand that offers a high service level accompanied with numerous benefits; (2) **Azul Seguros** – which provides simples and low-cost auto insurance for price sensitive buyers (low-end auto market); and (3) **Itau brand** – mostly focused on mid to high-income clients of Itau Unibanco, with a strong presence across the country.

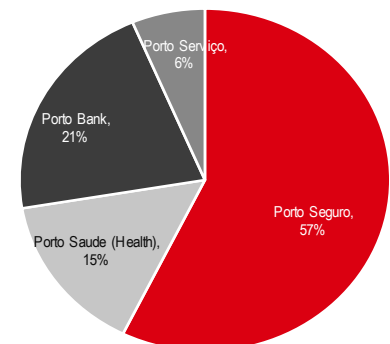
Products and services are mostly distributed through its wide network of independent agents. As of 2023, the company had an operational structure and distribution chain of approximately 13,000 employees, 37,000 independent brokers, 13,000 service providers, and 55 branches, serving around 16m clients in Brazil.

Revenue diversification by business verticals



Source: Company data; from 1Q 2024, Porto started reporting Porto Serviço, its new vertical that offers a portfolio of residential, business, and automotive assistance services

Net income breakdown by business verticals (1Q 2024)



Source: Company data

Evolution of the company

Qualitas's evolution

Year	Description
1945	Porto Seguro started its operations as a small insurance company in São Paulo
1972	Founder Abrahao Garfinkel acquired Porto Seguro from Bradesco
1976-2002	Started new business lines: Life and Pension, Health, Portopar (Asset Manag.), Consortium, and Financing services
2003	Porto Seguro acquired AXA Brasil (controlled by AXA), which is currently known as Azul Seguros; transaction led Porto Seguro to rank 1st in auto insurance. Azul primarily focused on the low end of the auto market
2004	Launched IPO and listed on B3, raising BRL129m (66% secondary)
2007	Launched credit card
2009	Entered deal with Itaú Unibanco, enabling the bank to transfer its auto and residential insurance portfolio to Porto in exchange for 43% interest in the new company, Porto Seguro Itaú Unibanco Participações (PSIUPAR)
2016	Acquisition of Chubb do Brasil's auto insurance portfolio
2017	Acquisition of AIG Seguros Brasil's auto insurance portfolio
2021	Porto Serviços acquired a 13.5% stake Petlove, the largest platform for online sales of pet products in Brazil and transferred control of Porto.Pet (veterinary medicinal services) to Petlove
2021	Segmented its businesses into four verticals: Insurance, Healthcare, Bank, and Services.
2021-22	Acquisition of Segfy (offers technological and innovative solutions for brokers), Conectcar (segment of automatic payments in toll roads, parking lots, and drive-thrus as well as other service), Atar (BaaS fintech), Plugify (tech company that offers electronic equipment rental and integrated IT management for corporates),
2022	Coinsurance agreement with Mitsui Sumitomo for auto, homeowner, and SMEs products
2022	Merger of Porto Assistência with CDF, a B2B assistance company that provides customer care support and consultancy services
2022	The acquisition of Unigás, an installation and technical assistance company to gas heating systems

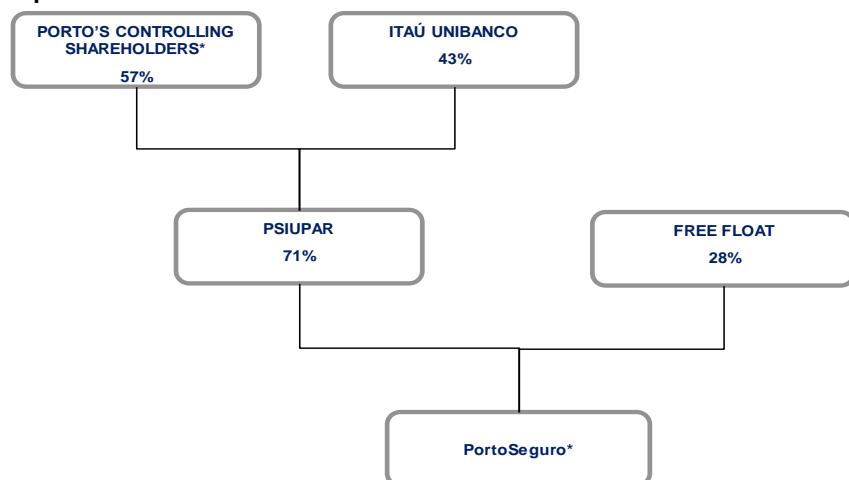
Source: Company data

Ownership structure

In 2009, Porto Seguro entered into a partnership with Itaú Unibanco, the largest private bank in Brazil by assets, merging home and auto insurance operations. Through this partnership, Porto Seguro acquired Itaú's auto and residential insurance portfolio in exchange for a 43% stake in PSIUPAR (Porto Seguro Itaú Unibanco Participações), Porto Seguro's holding company.

Controlling shareholders the Garfinkel family holds 40.5% of Porto Seguro through their 57% stake in PSIUPAR (the holding company), while Itaú Unibanco holds 30.5% of Porto Seguro through their 43% stake in PSIUPAR. The remaining 28% of Porto Seguro is free float.

Ownership structure



Source: Company data; *Garfinkel family, controlling shareholders

Management and board of directors

CEO Paulo Kakinoff was appointed in January 2024, succeeding Roberto Santos who became a board member. Celso Damadi is Executive VP – Financial, Controllership and Investments.

Porto Seguro: Senior management

Names	Position	In current position since	At Porto since
Paulo Sérgio Kakinoff	CEO	Jan 2024	2024
Celso Damadi	Executive Vice President – Financial, Controllership and Investments	2016	2005
Lene Araújo de Lima	Executive Vice President – Corporate and Institutional	2019	1994
José Rivaldo Leite da Silva	Executive Vice President – Insurance	2023	1996
Marcos Roberto Loução	Executive Vice President – Financial Businesses and Services	2019	2008
Luiz Augusto Arruda	Executive Vice President – Marketing, Clients, Data and Commercial	2023	-
Sami Foguel	Executive Vice President – Healthcare	2021	-
Domingos de Toledo Piza Falavina	Investor Relations Officer	2023	2023

Source: Company

Board of Directors

Porto's Board of Directors is composed of seven members, including two appointed by the Garfinkel Family, two appointed by Itau Unibanco, and three independent directors (43% of the total). Chairman **Bruno Garfinkel** took over leadership of the board in 2019 from his father, Jayme Garfinkel, who had held the position for 41 years. Prior to Jayme's tenure, the chairman was Abrahão Garfinkel, Jayme's father, who acquired Porto in 1972.

Porto: Board of Directors

Names	Position	BoD since	External or Previous Position
Bruno Campos Garfinkel	Chairman	2017	20 years of experience in Porto operations and joined the Board seven years ago
Marco Ambrogio Crespi Bonomi	Vice Chairman	2015	Was General Director and Advisor at Itau Unibanco
André Luis Teixeira Rodrigues	Director	-	Executive Director Coordinator of Retail Banking at the Itau Unibanco Group
Roberto Souza Santos	Director	2024	Executive President of Porto
Lie Uema do Carmo	Independent Director	-	Lawyer and Partner at Uema do Carmo and Professor at FGV Direito SP
Patrícia Calfat	Independent Director	-	YouTube Latam Regional Director
Pedro Luiz Cerize	Independent Director	2008	Founding partner and co-manager of Skopos Investimentos

Source: Company data

Financials & valuation: Porto Seguro

Hold

Financial statements

Year to	12/2023a	12/2024e	12/2025e	12/2026e
P&L summary (BRLm)				
Gross written premium	26,186	28,150	30,402	32,834
Net earned premium	24,745	26,742	28,578	30,535
Income from credit operations	3,316	3,809	4,472	5,039
Non-insurance revenues	2,771	3,602	4,142	4,557
Total Revenues	30,832	34,153	37,192	40,131
Insurance claims	(13,905)	(14,849)	(16,012)	(17,079)
Acquisition costs	(5,406)	(5,941)	(6,405)	(6,875)
Net operating expenses	(9,005)	(10,868)	(12,165)	(13,499)
Total Expenses	(28,316)	(31,659)	(34,582)	(37,453)
Operating profit	2,516	2,494	2,611	2,678
Finance income / cost	1,028	1,102	1,108	1,182
Profit-before tax	3,544	3,596	3,718	3,860
Taxation	(1,229)	(1,223)	(1,227)	(1,274)
PAT	2,315	2,374	2,491	2,586
Minorities + pref dividend	(49)	(40)	(40)	(30)
Attributable profit	2,266	2,334	2,451	2,556
HSBC attributable profit	2,266	2,334	2,451	2,556
Balance sheet summary (BRLm)				
Cash & securities	1,105	1,397	1,510	1,631
Investments	18,094	17,734	18,849	20,357
Intangibles	3,817	3,817	3,817	3,817
Total assets	54,852	59,683	65,604	72,028
Technical reserves	21,352	23,083	25,537	27,909
Shareholders' equity	12,235	13,322	14,490	15,330
TNAV	8,418	9,505	10,673	11,513

Growth & per share analysis

Year to	12/2023a	12/2024e	12/2025e	12/2026e
Per share				
EPS reported (fully diluted)	3.5	3.6	3.8	3.9
HSBC EPS (fully diluted)	3.5	3.6	3.8	3.9
DPS	1.3	1.9	2.0	2.6
BVPS	18.9	20.6	22.4	23.7
TBVPS	13.0	14.7	16.5	17.8
Shares outstanding - eop (in m)	647	648	648	648
Y-on-Y % change				
Total assets	11.5	8.8	9.9	9.8
Investments	31.2	(2.0)	6.3	8.0
Technical reserves	9.9	8.1	10.6	9.3
Shareholders' equity	15.6	8.9	8.8	5.8
Net Earned Premiums (NEP)	24.7	8.1	6.9	6.9
Total Revenues	24.5	10.8	8.9	7.9
Total Expenses (insurance)	16.2	10.5	7.4	6.7
Total Expenses (consolidated)	17.7	11.8	9.2	8.3
Finance income / cost	70.1	7.2	0.5	6.7
Attributable profit	100.4	3.0	5.0	4.3
HSBC EPS (recurring)	100.4	3.0	5.0	4.3

Ratios (%)

Year to	12/2023a	12/2024e	12/2025e	12/2026e
Claim ratio	56.2	55.5	56.0	55.9
Acquisition ratio	19.9	20.0	20.0	20.0
Combined ratio	91.4	93.5	94.0	93.9
Cost / income (consolidated)	91.8	92.7	93.0	93.3
Investment yield (ROAI)	6.1	6.1	6.0	5.9
Effective tax rate	34.7	34.0	33.0	33.0
ROAA, recurring	4.4	4.1	3.9	3.7
ROAE, recurring	19.9	18.3	17.6	17.1
Solvency ratio	145.8	149.8	150.7	150.2
Tangible equity / assets	15.3	15.9	16.3	16.0
Equity / assets	22.3	22.3	22.1	21.3
Payout ratio	74.1	55.0	55.0	70.0
Operating leverage (NWP / equity)	2.1	2.1	2.1	2.1

Valuation data

Year to	12/2023a	12/2024e	12/2025e	12/2026e
PE reported*	8.5	8.2	7.8	7.5
P / BV	1.6	1.4	1.3	1.3
P / TBV	2.3	2.0	1.8	1.7
Dividend yield (%)	4.4	6.5	6.7	8.9

* Based on diluted shares

ESG metrics

Environmental Indicators	12/2022a	Governance Indicators	12/2023a
GHG emission intensity*	n/a	No. of board members	7
Energy intensity*	n/a	Average board tenure (years)	na
CO ₂ reduction policy	Yes	Female board members (%)	14.3
Social Indicators		Board members independence (%)	42.9
Employee costs as % of revenues	n/a		
Employee turnover (%)	n/a		
Diversity policy	Yes		

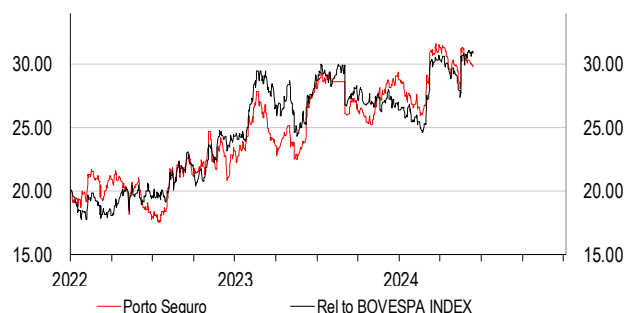
Source: Company data, HSBC

* GHG intensity and energy intensity are measured in kg and kWh respectively against revenue in USD '000s

Issuer information

Share price (BRL)	29.66	Free float	29%
Target price (BRL)	33.00	Sector	Insurance
RIC (Equity)	PSSA3.SA	Country/Region	Brazil
Bloomberg (Equity)	PSSA3 BZ	Analyst	Jitendra Singh
Market cap (USDm)	3,581	Contact	+52 55 7330 6050

Price relative

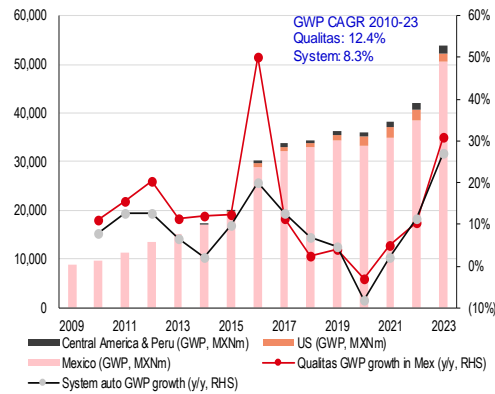


Source: HSBC

Note: Priced at close of 13 Jun 2024

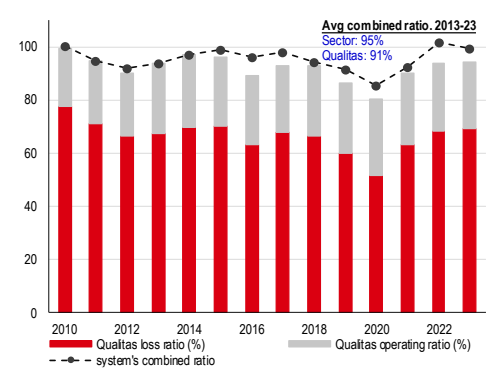
Qualitas: Investment thesis in charts

Over the years, Qualitas has shown resilient growth, consistently outpacing the industry



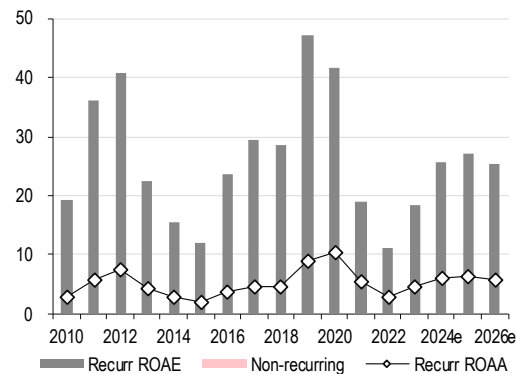
Source: Company data, AMIS

Solid underwriting performance, along with healthy investment income...



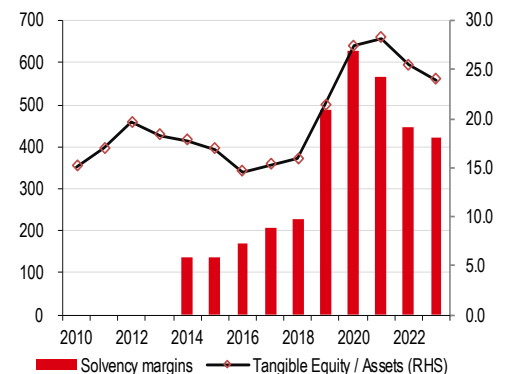
Source: Company data, AMIS

... has allowed it to deliver strong ROAEs; we believe >20% ROE is sustainable



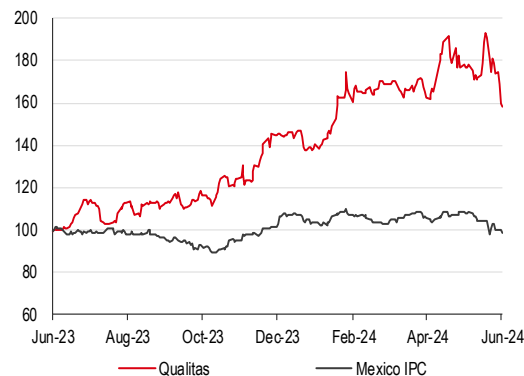
Source: Company data, HSBC

Strong capital position is paving the way for potentially higher dividend payouts



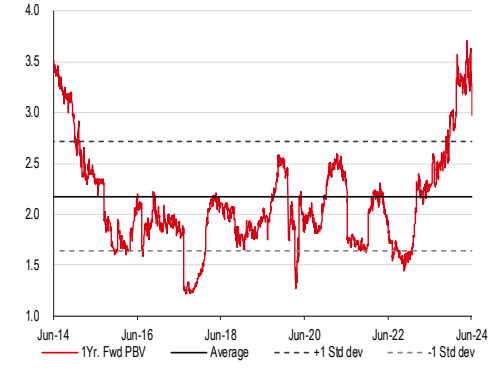
Source: Company data

However, the strong performance is already reflected in the stock price, which has risen 53% in the last year



Source: Refinitiv Datastream; rebased to 100 as of 1 Jan 2023

Current valuation looks demanding; the stock trades at 2024 PBV (x) of 3.0x, a 35% premium to its 3yrs historical avg



Source: Refinitiv Datastream

Qualitas

- ◆ Qualitas is Mexico's largest auto insurer, with a market share of c33% in terms of GWP
- ◆ The company has grown consistently, with a 2010-23 GWP CAGR of 14%, and the stock rose c88% in 2023 and 6% YTD
- ◆ However, we initiate coverage with a Reduce rating and MXN165 given demanding valuation and an increase in country risk (CoE)

Investment positives

Leading insurer in the Mexican auto insurance market

Qualitas is Mexico's leading auto insurance company, with a GWP market share of c33%. It has maintained its leadership position now for 17 consecutive years. It has also increased its market share organically from 20% in 2010 to 33% in 2023, a feat that is hard to replicate, in our view. Qualitas has c28% market share in light-vehicles and a 44% share in trucks. We believe its leadership position is sustainable in the long run as Mexico's auto insurance market still exhibits lower penetration levels compared to other regions and provides potential room for growth.

Resilient growth over the years, outpacing industry growth

Over the past decade, the company has consistently delivered growth both in terms of premium and number of units insured, demonstrating resilience, despite operating in a challenging environment and in a competitive market. Since 2010, premiums have grown at a 2010-23 CAGR of 14%, while insured units grew at 9%. We believe that Qualitas is well positioned to achieve healthy growth and sustainable expansion in the medium term as it benefits from an improved macro environment, and the emerging opportunities from nearshoring. We forecast a 2023-30e premium CAGR of 11%

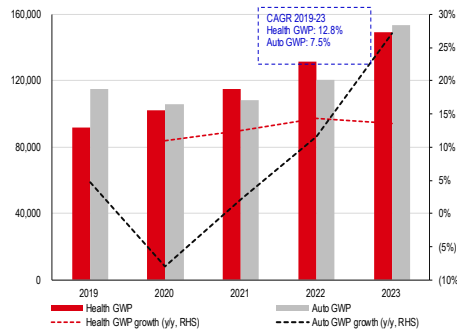
Unlocking growth: Expanded into health insurance in Mexico, leveraging its strong distribution network; started operations in Colombia

Recently the company has ventured into the health insurance sector in Mexico through its subsidiary, Qualitas Salud, targeting the middle-class population segment in Mexico (C socioeconomic level). We see important long-term growth potential in the health insurance market given that 92% of the Mexican population is without any private insurance. Only c16% of the population in Mexico possesses any type of private personal accident insurance coverage, only c10% has private coverage for medical expenses, and only 1% has a private health insurance policy. By entering this segment, Qualitas aims to address this gap and capitalize on new growth opportunities in the Mexican insurance landscape. The company has the largest distribution network in Mexico which has been a key competitive advantage, with 571 offices, 22,000 agents and 6,600 employees.

The health insurance industry is a concentrated market in Mexico as the top five insurers hold c74% market share (*GNP has c25% share, AXA c19% share, Metlife c18% share, NYL c9% share, and Atlas with c4% share*). According to AMIS figures, agents and brokers represent the main sales distribution channel of the industry, with 84% share.

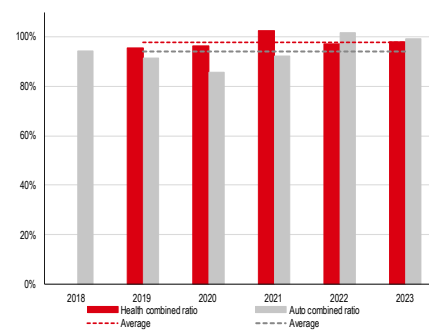
At present, we have refrained from factoring in the potential impact of the Qualitas Salud business in our estimates as it remains at an early stage. However, we acknowledge the fact that it adds upside risk to our estimates. In the long run, management targets to have c70% of revenues from Mexico or its vertical subsidiaries, and the remainder from outside of Mexico.

Mexico: GWP for health and auto insurance sector (MXNm)



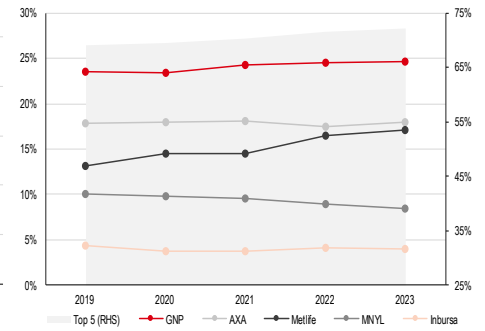
Source: AMIS, Qualitas

Mexico: Combined ratio for health and auto insurance sector



Source: AMIS, Qualitas

Mexico: Health GWP market share



Source: AMIS, Qualitas; MNYL- Monterrey New York Life

A vertical integration strategy (non-insurance subsidiaries)

Qualitas has been actively focusing on vertical integration through its subsidiary Flekk, providing complementary services such as the supply of auto parts, crystals, and windscreens, and the repair of windscreens. The vertical subsidiary allows Qualitas to reduce costs, improve operational efficiencies, provide better service to policyholders, and increase profitability. In 2023, the company also acquired a majority stake in a technology company focusing on telemetry.

Focused on technological innovation, resulting in improved service quality

On a recent field trip to Qualitas’s national call center, we were impressed by the array of innovative in-house tools developed by the company to provide better services to its clients, maintain a closer relationship with its customers, and provide assistance to the service officers and agents during the claim process. The company has developed in-house tools such as: (1) QMobile App, designed for quick road assistance to policy holders in case of a claim. According to management, the arrival of a claims officer averages c20 mins; (2) Qualitas GPS to locate the policyholder in case of causality and assigns the closest available claim officer to it 3); WhatsApp assistance to policyholders; and (4) Qualitas express adjustment for remote attention in areas where a claims office is not available. This continuous innovation and in-house technological developments have helped the company to achieve greater efficiency and a closer relationship with policy holders.

Improved stock trading liquidity

Over the last few years, the liquidity of the stock has improved significantly, with an average 6-month ADTV of cUSD12m (from USD1m in 2018) vs cUSD8m for SME lenders Regional and Bajio, and USD5-6m for Inbursa and Genera. The company has a free float of c24%. In the last few years, the company’s management and the IR team have been more proactive in engaging with investors and analysts, leading to greater investor attention and stock trading activity. During 2022, Qualitas announced a MXN1bn share buy-back program and cancelled c6m treasury shares (1.5% of the share count). In April 2024, the company announced a new share buyback program of MXN800m.

Professional management with rich experience

Qualitas was founded in 1994 by Joaquín Brockman Lozano. Although the family of the founder still owns the majority of the company (through a trust), currently they exert limited influence in the operation of the business (Joaquín Brockmann Domínguez, son of Mr. Lozano, is currently a board member, and works in the commercial area, being responsible of agent services and foreign subsidiaries). Most of the top executives of Qualitas have rich experience and extensive knowledge of the auto insurance market. **CEO Jose Antonio Correa** has held the position since January 2018 and was previously the CFO of the company for three years. He has also held CFO positions with other companies during his career, including P&G Mexico for North America and Seguros Monterrey New York Life. Thus, he has broad experience in the industry. **Deputy CEO Bernardo Eugenio Risoul Salas** was appointed to the position in April 2023. Previously, he served as CFO and CEO of the international operations. He has more than 20 years of experience in international companies. We emphasize the management's proactive approach to engaging with investors and analysts, clearly defining medium-term targets, particularly for underwriting ratios, and offering annual guidance.

Strong capital position paving the way for potential extraordinary dividends

Qualitas's capital remains exceptionally strong, with a solvency ratio at 336% and tangible equity to asset of 24.0x, well surpassing the regulatory thresholds and internal policy of the company. Internally, the company has established a policy of distributing 40-90% of earnings as dividends. With such ample capital, we see an opportunity for increased shareholder distributions. We forecast the dividend payout to be at the higher end of the policy range in 2025-26e and then stabilize at 60% over the medium term to long term; we forecast a dividend yield of 4-6% in 2024-26e

Investment concerns

Rich valuation metrics

In 2023 and so far this year, Qualitas has emerged as one of the strongest performing stocks in LatAm, rising c88% in 2023 and 6% YTD in local currency, despite a 17% decline following the presidential election outcome on 2 June 2024. Investors have been drawn to its robust growth (28% premium growth in 2023), consistent performance, and strong fundamentals. Qualitas stock is currently trading at a 2024e PE of 12.3x and PBV of 3.0x, a 16% premium to its 3-years historical average PE and 35% premium to its 3-years historical average PBV. In our view, the premium valuation reflects the market's confidence in the company's future growth prospects, its ability to generate high sustainable ROEs, and potential to pay higher dividends in the coming years given the company's strong capital position. However, we believe that these factors have been well factored into the stock price.

Qualitas: Price performance (rebased to 100)



Source: Refinitiv Datastream

Qualitas: 1-year forward PE (x)



Source: Refinitiv Datastream

Interest rate and FX risks from investment portfolio and international operations.

Qualitas’s investment portfolio stands at cMXN43.5bn and constitutes nearly 47% of its total assets, thereby exposing it to fluctuations in interest rates and market conditions. While a large part of portfolio is invested in government debt securities (more than 80% of the total) with an average duration of c1.5 years, lower rates will exert pressure on the company’s financial income at some point. In response, the company aims to bring its fixed income duration closer to 2 years in the coming period. Management calculates that each 25bp decline in the reference rate will result in a cMXN160m or c3% decline in 2024 net income. Given this sensitivity to interest rates, we expect that financial income will decrease, unless Qualitas can improve its operating margins as a counterbalance. However, this is likely to be quite challenging given the intense competition, higher inflation, and ongoing supply chain disruptions. Consequently, we expect lower interest rates to have a negative impact on profitability.

In terms of equity exposure, the company has strategy to invest mostly in global/ local ETFs, moving away from individual stock-picking. Additionally, Qualitas also faces FX risks as its c15% of its investment portfolio is allocated outside of Mexico, mostly in USD, while c9% of its insurance premiums come from outside of Mexico.

Emerging concerns from the auto parts supply chain in Mexico

Over the past few years, the automotive parts industry in Mexico has faced challenges, primarily stemming from supply chain shortages, exacerbated by intensified competition, particularly with new suppliers (i.e., Asian brands) entering the local market. These supply chain constrains (the availability of spare parts) have affected Qualitas and other insurance companies in Mexico, resulting in higher costs for auto parts and increased claim ratios.

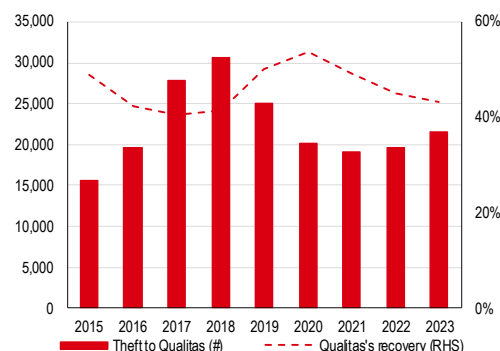
Execution risk in international operations and new health business

Qualitas started its health insurance business in Mexico (Qualitas Salud) in 2023, while simultaneously launching its insurance operations in Colombia. These strategic moves carry some execution risk. Reflecting on the past challenges, the company encountered some challenges in 2022 with its US operations (legal particularities, mainly in Texas), which led to losses. It is reassuring to note that the management took a proactive stance to address the issues in the US and is currently focused on turning the business around.

Increased theft resulting in higher claims

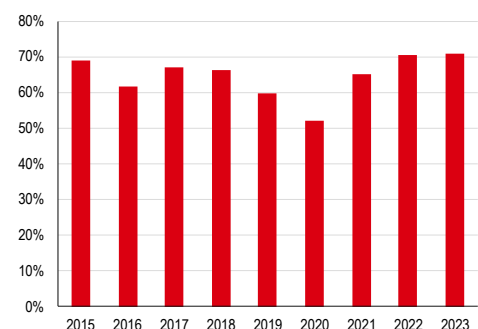
In the last few years, there has been a surge in auto theft and a reduction in the recovery rate, which had a negative effect on Qualitas’ claim ratio. Looking ahead, there remains a looming concern that if there is a further increase in auto thefts in coming years, it could exert additional pressure on the claim ratio. However, the company’s prudent claim, management and continuous innovation and in-house technological developments have helped Qualitas to keep the claim ratio below industry averages. Furthermore, the insurance industry also faced additional challenges from Hurricane Otis in 2023; however, Qualitas was somewhat insulated by its catastrophic reinsurance coverage.

Qualitas: Theft, recovery, and claims ratio



Source: Company data, AMIS

Claims ratio



Source: Company data; claims ratio= total claims/ net earned premium

Dependence on agents for distribution

Policyholders and companies in Mexico prefer to sell insurance products through agents because customers tend to favor the personalized interaction facilitated by agents, have lower awareness about the insurance products, and find the products too complex to understand. These agents offer personalized services to clients and guide them throughout the duration of their contract, gaining insights into their needs. For Qualitas, c60% of auto insurance products are sold through agents, 30% through financial institutions, and the remaining through direct channels, and other geographies. Agents receive commissions of 12-16% on policies sold and collected, and annual bonuses based on portfolio claim ratios to align incentives with the cost-control strategy. The commission paid to financial institutions is c19-20%. Although this structure allows companies to control acquisition costs and works as a cost-control strategy, it results in heavy dependence on agents for product sales.

Risk from tax-related contingency

On 8 February 2024, Qualitas announced that it has received a tax notification from Mexico's tax administration regulator Servicio de Administración Tributaria (SAT) regarding its fiscal year 2016 tax filing due to a change in VAT interpretation. SAT is currently conducting a tax and fiscal audit on the company in relation to this matter. The company has not disclosed any amount of tax credit or possible impact and has not made any provisions related to the case. Management anticipates no immediate impact on its financials or operations in the short term. However, it is important to note the potential negative effect in the case of an unfavorable outcome. This could result in a one-time cash outflow and could also negatively affect earnings.

Earnings sensitivity to policy rates

Our analysis of the sensitivity of earnings to an expedited cut in policy rates in Mexico suggests that every 100bps decline in EOP policy rate could negatively affect 2024-25e financial income by 5-10% and earnings by 3-5%.

Sensitivity to policy rate

MXNm	2023	2024e	2025e
Current assumptions			
Policy rate (T bills - 28-days, eop)	11.50%	10.25%	7.75%
Policy rate, avg	11.13%	10.88%	9.00%
CETES rate, avg	9.4%	10.5%	8.6%
Financial income	3,962	4,947	4,617
Net income	3,775	5,840	6,865
EPS	9.56	14.75	17.34
Shareholder's equity	21,397	24,065	26,843
ROAE	18.5%	25.7%	27.0%
Solvency ratio	420%	347%	358%
Assuming: -100bp for each year			
Policy rate (T bills - 28-days, eop)	11.50%	9.25%	6.75%
Policy rate, avg	11.13%	10.38%	8.00%
CETES rate, avg	9.4%	10.0%	7.6%
Financial income	3,962	4,723	4,132
Net income	3,775	5,683	6,516
EPS	9.56	14.36	16.46
Shareholder's equity	21,397	23,908	26,447
ROAE	18.5%	25.1%	25.9%
Solvency ratio	420%	344%	353%
% change			
Financial income		(4.5%)	(10.5%)
Net income		(2.7%)	(5.1%)
ROAE (p.p)		(0.60)	(1.09)
Solvency ratio (p.p)		(2.26)	(5.28)

Source: Company data, HSBC

Qualitas: Forecast drivers

- ◆ **Insurance premium growth:** We expect premium growth to remain healthy in 2024e, largely driven by further adjustment of existing policies to the new pricing that company introduced in 2H2023. Moreover, we expect moderate growth in new unit sale propelled by the ongoing recovery in new car sales. We forecast GWP growth of 17% in 2024e, 8% in 2025e, and 10% in the long run.
- ◆ **Underwriting performance:**
 - **Claims ratio:** After facing an elevated level of loss ratio in 2022-23 (c70% vs 10-years average of c65%), primarily driven by higher inflation rates and supply constraints in auto parts, we anticipate a slight improvement in loss ratio in 2024e. As inflation eases and supply chain disruptions are gradual alleviated, we expect the loss ratio should continue to make progress towards company's technical objective range of 62-65%.
 - **Acquisition and operating ratio:** We forecast the acquisition and operating ratio to remain within historical levels given that Qualitas's business model heavily depends on a network of external agents for product distribution.
 - **Combined ratio:** With consideration of the above factors, we expect a recovery in the underwriting part of the business, with a slight improvement in the combined ratio in 2024e vs the last two years. The company has a target of 92-94% in the medium to long term. We forecast a 2024e combined ratio at the top end of the target range. It is important to highlight that throughout its history, Qualitas has outperformed the sector, with a lower combined ratio (10-year avg of c91% vs the sector avg of 95%), mainly driven by: (1) effective and innovative use of technology in the claims process; (2) disciplined acquisition practices and efficient operation management; and (3) by leveraging its extensive experience in the auto insurance sectors.
- ◆ **Financial income:** We expect a strong 2024e ROAI, similar to result posted in 2023 given that the majority of the portfolio is invested in government debt securities (more than 80%) with a duration of c1.5 years. The company's strategy is to bring its fixed income portfolio duration close to two years before reference rate cuts begin in Mexico and makes equity investments mostly in global/ local ETFs.
- ◆ **Profitability:** In the last five years, Qualitas has delivered an average ROAE of c28% benefitting from lower claims during the pandemic and pricing adjustments in 2022-23. However, we believe that these levels of profitability are not sustainable, and we expect normalization of ROAE to 23% in 2030e, in line with management's sustainable ROE target of 20-25%.
- ◆ **Dividends:** Qualitas has a dividend policy to distribute dividend between 40% and 90% of the net income from previous year. Qualitas declared a dividend payout of c84% (MXN8 per share) on 2023 earnings, paid out in two instalments. Qualitas's capital remains exceptionally strong, with a solvency ratio at 336% and tangible equity to asset of 24.0x. We forecast dividend payout to be at the higher end of the dividend payment policy in 2024-26e and then stabilize at 60% over the medium term to long term.

Guidance for 2024e:

- ◆ Written Premium growth (GWP): Mid to high teens growth; 10% growth in long term.
- ◆ Loss ratio: 62-65% range
- ◆ Acquisition and operating ratio: in line with historical average
- ◆ Combined ratio: 92-94%
- ◆ ROI of c10%
- ◆ Effective tax rate: around 30%
- ◆ Sustainable ROE of 20-25%

Introducing our estimates

Our EPS estimates are 2-3% below Visible Alpha consensus for 2024-25e, and 6% below consensus for 2026e. We expect earnings momentum to remain robust in 2024e benefitting from further adjustment of premiums to the new tariffs and we expect 54% y-o-y EPS growth in 2024e, followed by 18% growth in 2025e, and flat EPS in 2026e (resulting from lower rates on financial income). We have a strong 2023-30e EPS CAGR projection of 14%.

HSBCe vs consensus				Key assumptions			
MXNm	2024e	2025e	2026e	%	2024e	2025e	2026e
HSBC net profit	5,840	6,865	6,803	GWP growth, y/y	17.0	8.0	10.0
Net profit consensus	6,036	7,197	7,346	Claims ratio (on NEP)	66.0	64.0	64.0
HSBC vs consensus	(3%)	(5%)	(7%)	Acquisition ratio (on NWP)	22.5	22.5	22.5
HSBC EPS (MXN)	14.75	17.34	17.18	Admin exp. Ratio (on NWP)	3.5	3.5	3.5
EPS consensus (MXN)	15.05	17.94	18.32	Combined ratio (on NEP)	92.0	90.0	90.0
HSBC vs consensus	(2%)	(3%)	(6%)	ROAI	10.5	9.1	6.9
				Effective tax rate	30.0	28.0	28.0

Source: Visible alpha, HSBC estimates

Qualitas: Annual summary (MXNm)

Income Statement	2019	2020	2021	2022	2023	2024e	2025e	2026e	CAGR 11-23a	CAGR 23-26e
Gross Written Premium (GWP)	36,158	35,947	38,225	42,036	53,726	62,860	67,888	74,677	14%	12%
Net Earned Premiums (NEP)	35,279	36,779	36,067	39,969	49,592	57,831	62,457	68,703	14%	11%
Insurance Claims	(21,105)	(19,210)	(23,437)	(28,194)	(35,174)	(38,168)	(39,973)	(43,936)	14%	8%
Acquisition Costs	(7,780)	(7,791)	(8,831)	(9,454)	(11,936)	(14,059)	(15,183)	(16,634)	15%	12%
Net Operating Expenses	(1,990)	(2,397)	(1,317)	(1,289)	(1,556)	(2,187)	(2,362)	(2,588)	15%	18%
Total Expenses	(30,876)	(29,399)	(33,585)	(38,937)	(48,667)	(54,414)	(57,518)	(63,158)	14%	9%
Operating Profit	4,403	7,380	2,482	1,032	925	3,417	4,940	5,546	5%	82%
Finance Income / Cost	2,882	1,975	2,274	1,423	3,962	4,947	4,617	3,930	16%	(0%)
Profit Before Tax	7,285	9,354	4,756	2,455	4,887	8,364	9,556	9,476	13%	25%
Tax Expenses	(1,934)	(2,564)	(987)	(245)	(1,096)	(2,509)	(2,676)	(2,653)	11%	34%
Profit After Tax	5,351	6,791	3,769	2,210	3,791	5,855	6,880	6,823	13%	22%
Minorities	(4)	(4)	(3)	(4)	(15)	(15)	(15)	(20)	15%	9%
Net Profit	5,347	6,786	3,766	2,206	3,775	5,840	6,865	6,803	13%	22%
Diluted EPS	12.79	16.60	9.40	5.58	9.56	14.75	17.34	17.18	15%	22%
% growth	128%	30%	(43%)	(41%)	71%	54%	18%	(1%)		
Diluted EPS, recurring	12.79	16.60	9.40	5.58	9.56	14.75	17.34	17.18	15%	22%
% growth	128%	30%	(43%)	(41%)	71%	54%	18%	(1%)		
BV per share	32.8	47.1	51.3	49.5	54.1	60.8	67.8	72.9	21%	10%
TBV per share	32.6	46.9	51.0	49.2	53.2	59.9	67.0	72.0	20%	11%
Ratios (%)	2019	2020	2021	2022	2023	2024e	2025e	2026e	Avg. 11-23a	Avg. 23-26e
Balance sheet										
Securities / Assets (%)	48.6	50.6	47.9	45.1	44.3	46.6	45.5	45.6	48.5	45.5
Receivables as % assets	36.8	34.4	33.8	34.3	35.2	34.1	35.7	35.9	36.2	35.2
Technical reserves / Assets (%)	56.9	49.7	52.7	55.5	55.5	58.9	57.5	56.9	60.0	57.2
Written premium										
Total GWP growth (y/y)	4.8	(0.6)	6.3	10.0	27.8	17.0	8.0	10.0	14.6	15.7
Total NEP growth (y/y)	10.9	4.3	(1.9)	10.8	24.1	16.6	8.0	10.0	14.7	14.7
GWP / Assets (%)	57.4	52.1	53.2	55.3	61.3	62.0	60.5	59.9	64.9	60.9
Technical reserves / GWP (%)	99.3	95.5	99.0	100.3	90.5	95.0	95.0	95.0	93.2	93.9
Financial income										
Financial income growth (y/y)	67.9	(31.5)	15.1	(37.4)	178.4	24.9	(6.7)	(14.9)	26.6	45.4
ROAI (Return on investments)	9.4	5.7	6.6	4.2	10.2	10.5	9.1	6.9	7.2	9.2
% of Cetes rate	121%	107%	151%	55%	110%	101%	107%	109%		
Cost										
Claims ratio (on NEP)	59.8	52.2	65.0	70.5	70.9	66.0	64.0	64.0	65.8	66.2
Acquisition ratio (on NWP)	21.6	21.9	23.3	22.8	22.3	22.5	22.5	22.5	22.6	22.4
Admin exp. ratio (on NWP)	5.5	6.7	3.5	3.1	2.9	3.5	3.5	3.5	3.6	3.4
Combined ratio (on NEP)	87.0	80.9	91.7	96.5	96.1	92.0	90.0	90.0	92.0	92.0
Total expense growth	26.9	20.4	(45.0)	(2.1)	20.7	40.5	8.0	9.6	22.5	19.7
Capitalization										
Solvency margins	487	631	565	446	420	347	358	351	342.6	369.0
Tangible equity / Assets	21.4	27.5	28.2	25.5	24.0	23.4	23.6	22.9	20.1	23.5
Equity / Assets	21.5	27.6	28.3	25.7	24.4	23.7	23.9	23.1	20.3	23.8
Div. payout	14.9	13.5	24.3	70.1	90.7	84.0	70.0	70.0	26.0	79.0
Profitability										
Effective tax rate	26.5	27.4	20.8	10.0	22.4	30.0	28.0	28.0	26.2	27.1
Operating margins (OI / NWP)	12.2	20.7	6.5	2.5	1.7	5.5	7.3	7.5	5.2	5.5
Net margins (NI / NWP)	14.9	19.1	9.9	5.3	7.0	9.3	10.2	9.2	7.9	8.9
ROAA, recurring	8.9	10.3	5.3	3.0	4.6	6.2	6.4	5.7	5.18	5.74
ROAE, recurring	47.2	41.6	19.1	11.1	18.5	25.7	27.0	24.4	26.62	23.89
Balance Sheet	2019	2020	2021	2022	2023	2024e	2025e	2026e	CAGR 11-23a	CAGR 23-26e
Cash & due from banks	1,783	1,692	2,209	2,860	3,953	4,400	4,752	5,227	32%	10%
Securities	29,735	34,893	34,320	34,265	38,849	47,145	50,916	56,755	15%	13%
Accounts receivable	23,188	23,718	24,269	26,070	30,825	34,573	40,054	44,806	15%	13%
Intangibles	89	97	103	124	337	337	337	337	57%	0%
Total Assets	63,041	69,039	71,888	75,988	87,688	101,379	112,207	124,646	16%	12%
Technical reserves	35,896	34,312	37,850	42,162	48,642	59,717	64,494	70,943	15%	13%
Other liabilities	13,581	15,665	13,660	14,307	17,602	17,546	20,817	24,807	16%	12%
Equity	13,559	19,052	20,366	19,499	21,397	24,065	26,843	28,840	19%	10%
Securities Growth	11%	14%	(1%)	(0%)	13%	21%	8%	11%	16%	11%
Technical Reserve Growth	(1%)	(4%)	10%	11%	15%	23%	8%	10%	14%	14%
Equity Growth	49%	41%	7%	(4%)	10%	12%	12%	7%	22%	7%
Payout Ratio	15%	14%	24%	70%	91%	84%	70%	70%	26%	79%

Source: Company data; HSBCe

1Q 2024 results: Strong start to the year

- ◆ Premium growth: Solid top-line performance (37% y/y) in 1Q 2024 was explained by further tariff adjustments coupled with strong new car sales; however, management believe that a large part of the tariff adjustments have already been incorporated in policies and prices should now evolve with inflation in 2H 2024 following historical patterns. The company expects growth will likely be in the mid to high teens for the full year, but stronger in 1H due to higher pricing carry -forward effect
- ◆ Loss ratio: Lower claim ratio in 1Q 2024 was due to (1) tariff adjustments; (2) positive effect of the holiday season (20% reduction in daily claims); and (3) lower levels of theft during the quarter. Management noted that 1Q 2024 had a seasonality effect, but the claims ratio should increase in 2Q 2024 and for the balance of the year. In general, claims in the second half of the year are higher due to climate changes
- ◆ Operating expenses: Increased during the quarter mainly due to: a) annual salary adjustments; (2) an increase in the headcount; and (3) higher provision for employees' profit sharing. Management expects the operating ratio to be around 3-4% going forward
- ◆ Investments portfolio: Consistent with its strategy, the company continued to increase its equity position, largely in US or global ETFs. Going forward, Qualitas plans to continue increasing its equity exposure to 15-20% of its total portfolio (from 13% in 1Q 2024)
- ◆ Higher effective tax rate in 1Q 2024 was due to increased provisions for employee profit-sharing payments and lower adjustments given stabilization of inflation
- ◆ US subsidiary: Continues to focus on restoring its profitability. Its US insurance portfolio now comprises cross border (86%) and domestic trucking (14%). A turnaround of its US subsidiary is still in progress and will take until 2026
- ◆ Solvency margin: A decline in solvency margins in 1Q 2024 was mostly due to change in Mexican accounting. In past years, Qualitas Mexico paid a dividend to the holding company; however, this year, the company has made a provision for a dividend payment of MXN3.2bn, which is no longer considered as excess capital

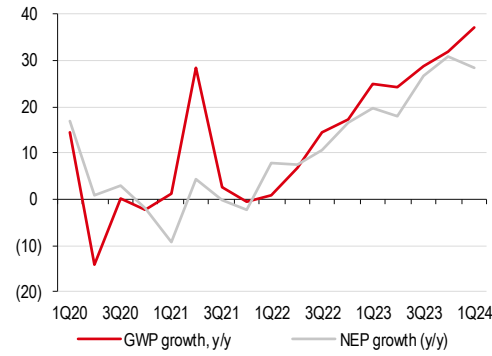
1Q 2024 results summary

MXNm	1Q23	2Q23	3Q23	4Q23	1Q24	Q-o-Q	Y-o-Y
Units Insured (m)	5.0	5.2	5.4	5.3	5.5	4%	11%
Premium per policy / Ticket size (MXN)	9,981	9,453	9,872	12,256	12,373	1%	24%
Securities	36,135	35,851	37,202	38,849	43,598	12%	21%
Securities Growth	5%	7%	11%	13%	21%	7.3pp	16.0pp
Technical Reserves	43,447	44,296	45,232	48,642	51,255	5%	18%
Technical Reserve Growth	13%	14%	15%	15%	18%	2.6pp	5.3pp
Equity	20,374	19,087	20,033	21,397	22,747	6%	12%
Gross Written Premium (GWP)	12,241	12,048	13,036	16,402	16,804	2%	37%
Net Earned Premiums (NEP)	11,117	11,689	12,756	14,030	14,293	2%	29%
Total Expense	(10,926)	(11,503)	(12,439)	(13,798)	(13,412)	(3%)	23%
Operating Profit	191	185	317	232	881	280%	361%
Finance Income / Cost	981	860	1,023	1,097	1,058	(4%)	8%
Profit before tax	1,172	1,046	1,340	1,329	1,939	46%	65%
Net income, recurring	896	745	1,021	1,113	1,234	11%	38%
Extraordinary items	0	0	0	0	0		
Net income, reported	896	745	1,021	1,113	1,234	11%	38%
Diluted EPS, recurring (in MXN)	2.27	1.89	2.59	2.82	3.12	11%	37%
Diluted EPS (in MXN)	2.27	1.89	2.59	2.82	3.12	11%	37%
BVPS (in MXN)	51.7	48.3	50.7	54.1	57.5	6%	11%
Total GWP growth (y/y, %)	25.0	24.2	28.9	32.0	37.3	5.26	12.31
Claims ratio %	69.5	71.9	71.6	70.7	64.1	(6.62)	(5.39)
Acquisition ratio %	23.5	22.6	21.9	21.4	21.3	(0.07)	(2.23)
Admin exp. ratio %	2.8	3.3	3.5	2.3	4.0	1.76	1.29
Combined ratio %	95.8	97.8	97.0	94.3	89.4	(4.93)	(6.33)
ROAI (Return on investments %)	11.1	9.6	11.2	11.5	10.3	(1.27)	(0.88)
Effective tax rate %	23.5	28.7	23.7	15.4	36.1	20.80	12.68
ROAE, recurring %	18.0	15.1	20.9	21.5	22.4	0.88	4.39
Solvency margins %	428	416	434	420	336	(84.03)	(91.56)
Tangible equity / Assets %	26.1	24.1	24.4	24.0	24.0	0.02	(2.04)

Source: Company data

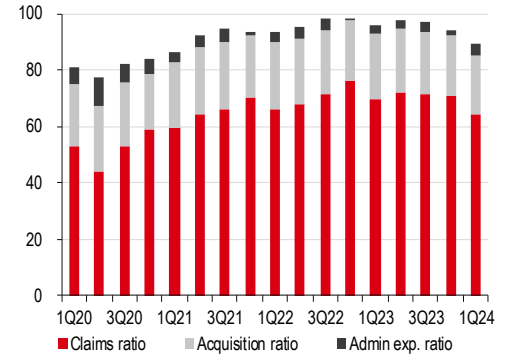
Qualitas: Quarterly charts

Premium growth (%)



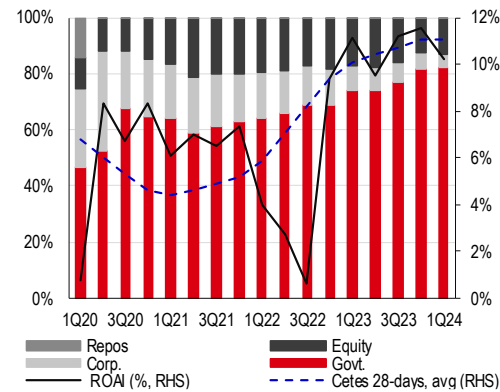
Source: Company data

Combined ratio (%)



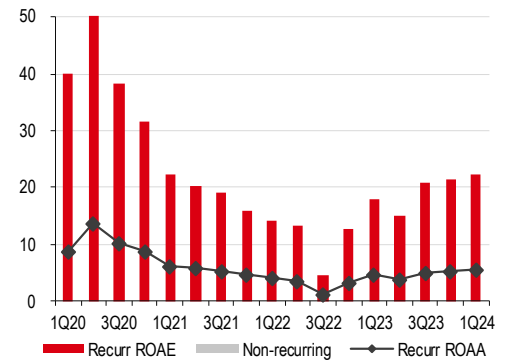
Source: Company data

Investment composition, ROAI and reference rate



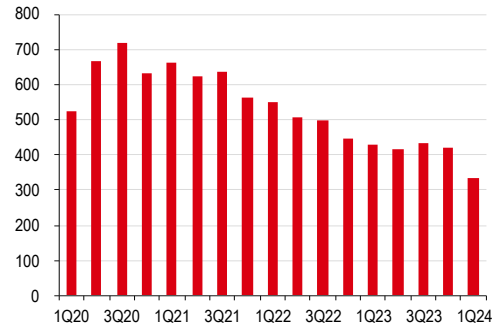
Source: Company data

Profitability indicators (%)



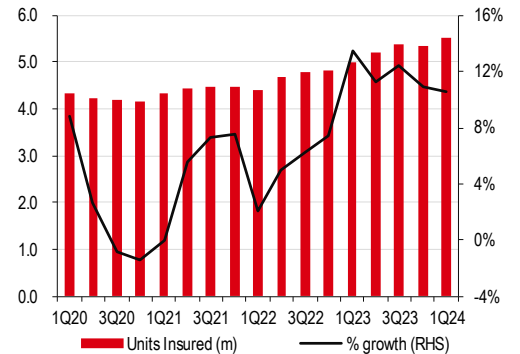
Source: Company data

Solvency margin (%)



Source: Company data

Units Insured (m)



Source: Company data

Overview of Qualitas

Introduction of the company

Qualitas was founded in 1994 by Joaquin Brockman Lozano in Mexico City. It is Mexico's largest auto insurance company, with a market share of c33% in terms of gross written premiums; c24% market share in light-vehicles and 46% share in trucks (market leader in both). Beyond its strong hold in Mexico, Qualitas has expanded its insurance operations into Central America (El Salvador with 8% market share; Costa Rica with 14% market share), Peru (5% market share), Colombia (launched in 2023), and the US (mostly focus on the cross border and bi-national products). These operations currently represent c8% of the holding company's issued premium, and management aims to reach up to 20% in the medium to long term. Moreover, the company has diversified itself by venturing into vertical subsidiaries (Flekk) dedicated to the installation of car glass and the supply of auto parts. Recently the company also ventured in the health insurance sector in Mexico (Qualitas Salud), indicating its forward thinking approach and potential for growth diversifications, but it is still at a very early stage.

As of 2023, the company has 5.4m insured units, serves its customers through a network of around 22,300 agents (external), and 568 offices (of which 340 are Qualitas Development Offices; ODQs). Qualitas was listed in the Mexican Stock Exchange in 2005.

Key competitive advantage: (1) Strong distribution network of external agents, alliance with financial institutions, and its own development offices (ODQs); (2) vertical integration that allows to control costs; (3) management with rich experience; (4) years of market experience in auto insurance; and (5) tech advancement that helps to provide better services and maintain closer relationships with its customers.

Evolution of the company

Qualitas's evolution

Year	Description
1994	Qualitas was founded
1996	Developed a decentralized expansion model, establishing a network of offices throughout the country
2001	Expansion of its distribution network reaching +2,300 agents
2005	Qualitas Compañía de Seguros's IPO on the Mexican stock exchange
2006	Strategic alliance with Financial Institutions, the financial branch of the main automotive assembly companies, incorporating a new distribution channel.
2007	Qualitas becomes leader in the Mexican automobile insurance market.
2009	Beginning of the vertical integration, with a stake in CristaFacil and Outlet de Refacciones
2010	Outlet de Refacciones is constituted, focused on the cutting, repairing, and marketing of salvage and pre-owned spare parts
2011	Began operation in Cost Rica
2011	Started setting up ODQs (Qualitas Development Offices)
2012	Launched Easy Car Glass, specialized in sale and installation of automobile glass
2012	Qualitas Controladora, replacing Qualitas Compañía de Seguros, began trading on the Mexican Stock Exchange.
2014	Beginning of Qualitas United States operation
2016	Began to operate under the regulation of Solvency II, its own reserve model
2019	Began operation in Peru
2019	Qualitas obtains total stake control of all its vertical subsidiaries: CristaFácil, Easy Car Glass and Outlet de Refacciones
2023	Acquired majority stake in a technology company focused on telemetry; the company is based in the US with presence in Mexico, Colombia and Costa Rica for USD15bn
2023	Started health insurance business in Mexico (Qualitas Salud)
2023	Began operation in Colombia

Source: Company data

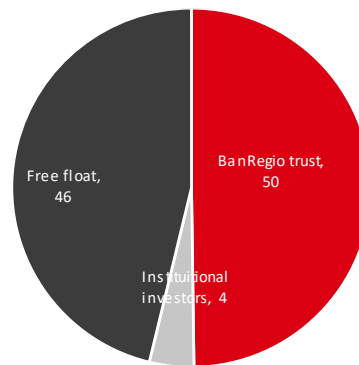
Ownership structure

After the death of founder and controlling shareholder Joaquin Brockman Lozano in 2021, his stake was transferred to a trust known as BanRegio 851-01287 trust. Currently, the trust holds the controlling stake of 49.78%, which belongs to Mr. Brockman's son and daughter. There are long term restrictions for selling the stake.

Mr. Lozano's son, Joaquin Brockmann Domínguez, is currently a board member and works in the commercial area of the company, with responsibilities for agent services and foreign subsidiaries.

Wilfrido Javier Castillo Sánchez Mejorada was also a founding member and held a c12% stake, which was transferred to his family when he passed away in March 2020. However, of that 12%, only 1.13% is now owned by family members (Castillo Miranda Olea, currently independent board member).

Ownership structure (%)



Source: Company data

Management and board of directors

Chairman of the Board and CEO **José Antonio Correa Etchegaray** has held these positions since January 2021. He has also been the CEO of Qualitas Mexico since January 2018 and previously served as CFO of the same company for over three years. Deputy CEO **Bernardo Eugenio Risoul Salas** was appointed to the role in April 2023. Prior to this position, he served as CFO and CEO for International operations.

Qualitas: Senior management

Names	Position	In current position since
José Antonio Correa	CEO	2018
Bernardo Risoul	Deputy CEO	2023
Joaquín Brockmann Domínguez	Attention to Offices and Special Projects Director	2019
Alejandro Elizondo	Chief Investment Officer	2020
José Alberto González	Claims Service Director	2017
Enrique Vera	Claims Customer Service Director	-
Pilar Moreno	Technical Director	2016
Martha Macías	Chief Operations Officer	2014
Juan Carlos Urquiza	Chief Information Officer	-

Source: Company data

Board of Directors

Qualitas' board of directors consists of 12 members, of which 8 are independent directors (69% of the total) and 4 are related directors (33% of the total). The average tenure of the members is c4.3 years.

Qualitas: Board of Directors

Name	Type	Committees				
		Corporate practices	Audit	Social Responsibility	Investment, Finance & Planning	Operations
José Antonio Correa Etchegaray*	R			✓	✓	✓
Bernardo Eugenio Risoul Salas**	R			✓	✓	✓
Joaquín Brockmann Domínguez	R			✓	✓	✓
María del Pilar Moreno Alanís	R					✓
Wilfrido Javier Castillo Miranda Olea	I				✓	
Juan Marco Gutiérrez Wanless	I	✓			✓	
Mauricio Domenge Gaudry	I	✓	✓			
Madeleine Marthe Claude Brémond Santacruz	I					
Alfonso Tomás Lebrija Guiot	I	✓	✓			
José Francisco Torres Olmos	I				✓	
Luis Celhay López	I		✓			
David Coppel Calvo	I				✓	

Source: Company data

R: Proprietary Related; I: Proprietary Independent; *President; **Vice President

Financials & valuation: Qualitas

Reduce

Financial statements

Year to	12/2023a	12/2024e	12/2025e	12/2026e
P&L summary (MXNm)				
Gross written premium	53,726	62,860	67,888	74,677
Net earned premium	49,592	57,831	62,457	68,703
Income from credit operations	-	-	-	-
Non-insurance revenues	-	-	-	-
Total Revenues	49,592	57,831	62,457	68,703
Insurance claims	(35,174)	(38,168)	(39,973)	(43,936)
Acquisition costs	(11,936)	(14,059)	(15,183)	(16,634)
Net operating expenses	(1,556)	(2,187)	(2,362)	(2,588)
Total Expenses	(48,667)	(54,414)	(57,518)	(63,158)
Operating profit	925	3,417	4,940	5,546
Finance income / cost	3,962	4,947	4,617	3,930
Profit-before tax	4,887	8,364	9,556	9,476
Taxation	(1,096)	(2,509)	(2,676)	(2,653)
PAT	3,791	5,855	6,880	6,823
Minorities + pref dividend	(15)	(15)	(15)	(20)
Attributable profit	3,775	5,840	6,865	6,803
HSBC attributable profit	3,775	5,840	6,865	6,803
Balance sheet summary (MXNm)				
Cash & securities	3,953	4,400	4,752	5,227
Investments	38,849	47,145	50,916	56,755
Intangibles	337	337	337	337
Total assets	87,688	101,379	112,207	124,646
Technical reserves	48,642	59,717	64,494	70,943
Shareholders' equity	21,397	24,065	26,843	28,840
TNAV	21,060	23,729	26,506	28,503

Growth & per share analysis

Year to	12/2023a	12/2024e	12/2025e	12/2026e
Per share (MXN)				
EPS reported (fully diluted)	9.6	14.8	17.3	17.2
HSBC EPS (fully diluted)	9.6	14.8	17.3	17.2
DPS	5.1	8.0	10.3	12.1
BVPS	54.1	60.8	67.8	72.9
TBVPS	53.2	59.9	67.0	72.0
Shares outstanding - eop (in m)	395	396	396	396
Y-o-y % change				
Total assets	15.4	15.6	10.7	11.1
Investments	13.4	21.4	8.0	11.5
Technical reserves	15.4	22.8	8.0	10.0
Shareholders' equity	9.7	12.5	11.5	7.4
Net Earned Premiums (NEP)	24.1	16.6	8.0	10.0
Total Revenues	24.1	16.6	8.0	10.0
Total Expenses (insurance)	16.2	10.5	7.4	6.7
Total Expenses (consolidated)	17.7	11.8	9.2	8.3
Finance income / cost	178.4	24.9	(6.7)	(14.9)
Attributable profit	71.2	54.7	17.6	(0.9)
HSBC EPS (recurring)	71.2	54.7	17.6	(0.9)

Ratios (%)

Year to	12/2023a	12/2024e	12/2025e	12/2026e
Expense ratios				
Claim ratio	70.9	66.0	64.0	64.0
Acquisition ratio	22.3	22.5	22.5	22.5
Combined ratio	96.1	92.0	90.0	90.0
Cost / income (consolidated)	98.1	94.1	92.1	91.9
Investment yield (ROAI)	10.2	10.5	9.1	6.9
Effective tax rate	22.4	30.0	28.0	28.0
ROAA, recurring	4.6	6.2	6.4	5.7
ROAE, recurring	18.5	25.7	27.0	24.4
Solvency ratio	420.4	346.6	358.0	351.1
Tangible equity / assets	24.0	23.4	23.6	22.9
Equity / assets	24.4	23.7	23.9	23.1
Payout ratio	90.7	84.0	70.0	70.0
Operating leverage (NWP / equity)	2.5	2.6	2.5	2.6

Valuation data

Year to	12/2023a	12/2024e	12/2025e	12/2026e
PE reported*	19.0	12.3	10.5	10.6
P / BV	3.4	3.0	2.7	2.5
P / TBV	3.4	3.0	2.7	2.5
Dividend yield (%)	2.8	4.4	5.7	6.7

* Based on diluted shares

ESG metrics

Environmental Indicators	12/2022a	Governance Indicators	12/2023a
GHG emission intensity*	n/a	No. of board members	12
Energy intensity*	n/a	Average board tenure (years)	4.3
CO ₂ reduction policy	Yes	Female board members (%)	16.7
Social Indicators		Board members independence (%)	66.7
Employee costs as % of revenues	n/a		
Employee turnover (%)	14.7		
Diversity policy	Yes		

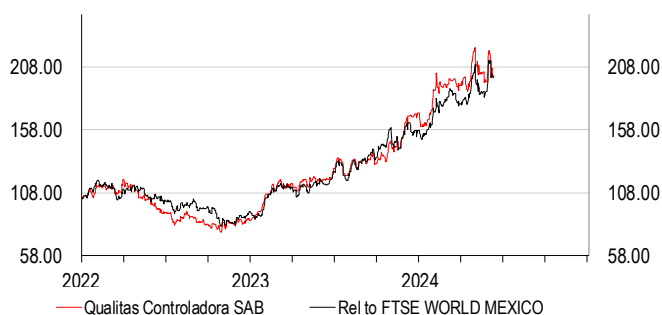
Source: Company data, HSBC

* GHG intensity and energy intensity are measured in kg and kWh respectively against revenue in USD '000s

Issuer information

Share price (MXN)	181.59	Free float	46%
Target price (MXN)	165.00	Sector	Insurance
RIC (Equity)	Q.MX	Country/Region	Mexico
Bloomberg (Equity)	Q* MM	Analyst	Jitendra Singh
Market cap (USDm)	3,907	Contact	+52 55 7330 6050

Price relative



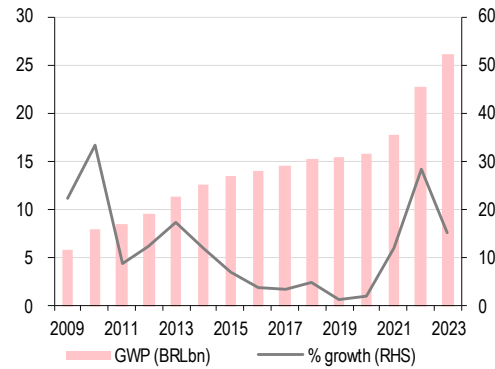
Source: HSBC

Note: Priced at close of 13 Jun 2024

Peer review: Porto Seguro vs Qualitas in charts

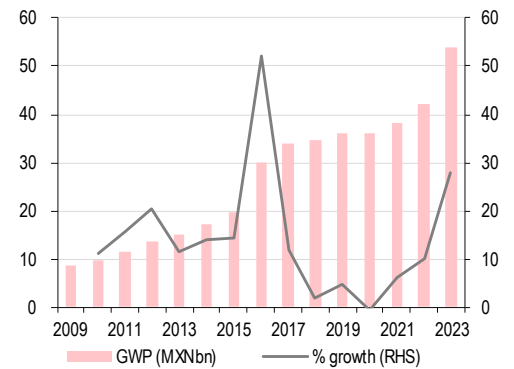
In the charts below, we compare and contrast Porto Seguro and Qualitas on various parameters.

Porto Seguro: Gross Written Premium (GWP)



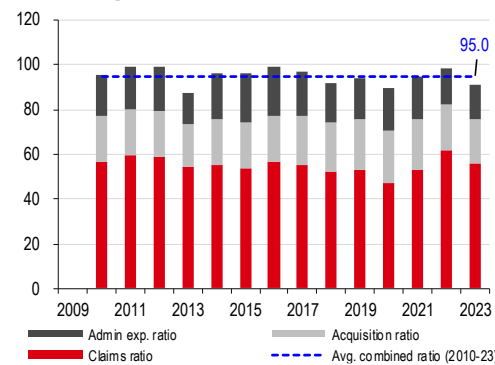
Source: Company data

Qualitas: Gross Written Premium (GWP)



Source: Company data

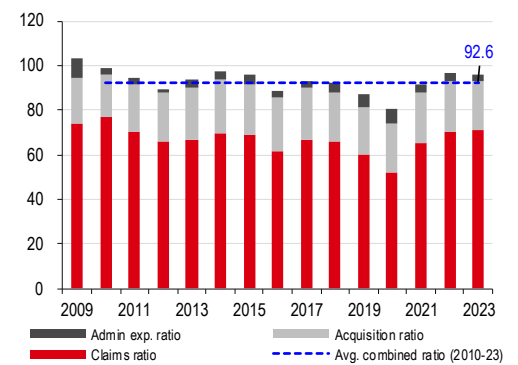
Porto Seguro: Combined ratio (%) *



Source: Company data

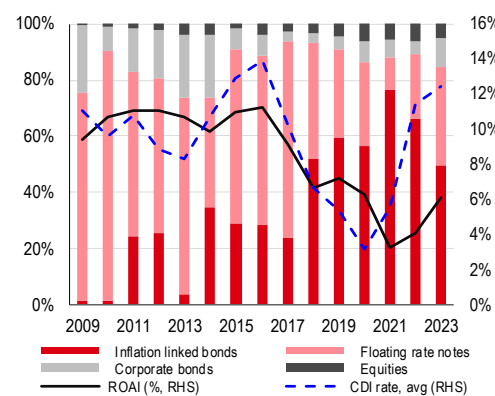
*for insurance operations; Admin exp. includes tax and other income/expense

Qualitas: Combined ratio (%)



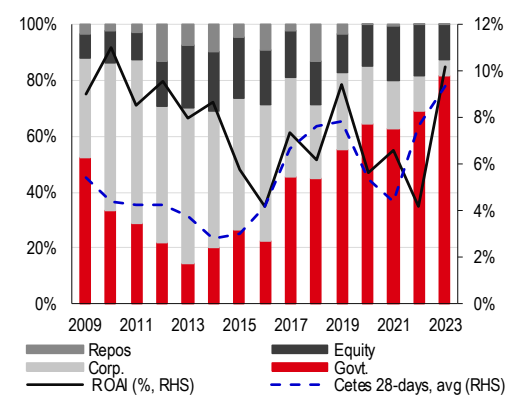
Source: Company data

Porto Seguro: Investment composition, ROAI and reference rate



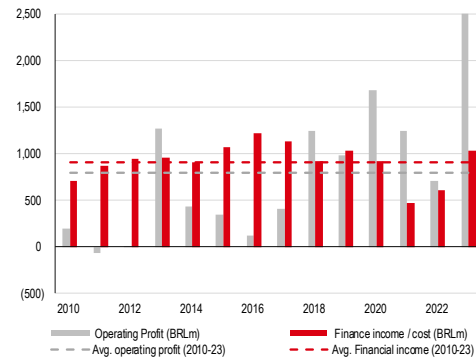
Source: Company data

Qualitas: Investment composition, ROAI and reference rate



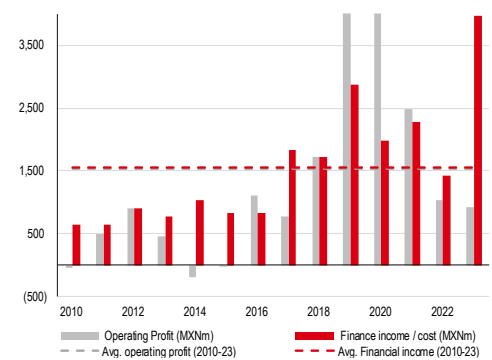
Source: Company data

Porto Seguro: Operating profit and financial income



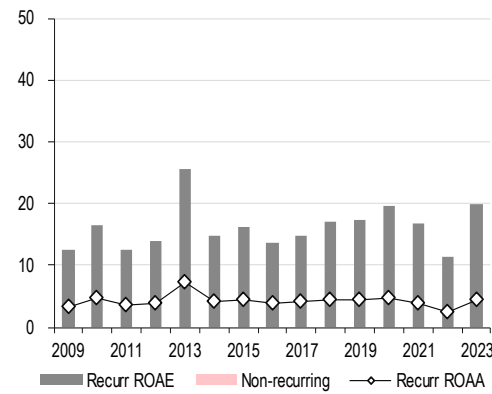
Source: Company data

Qualitas: Operating profit and financial income



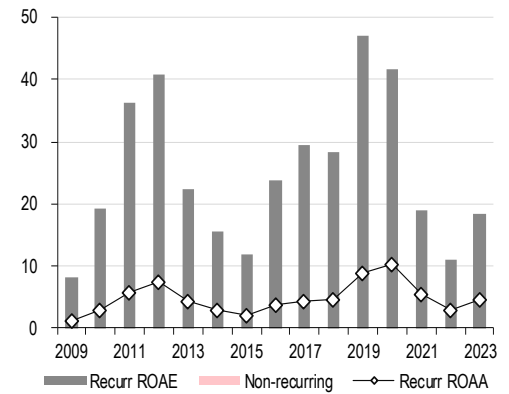
Source: Company data

Porto Seguro: Profitability (%)



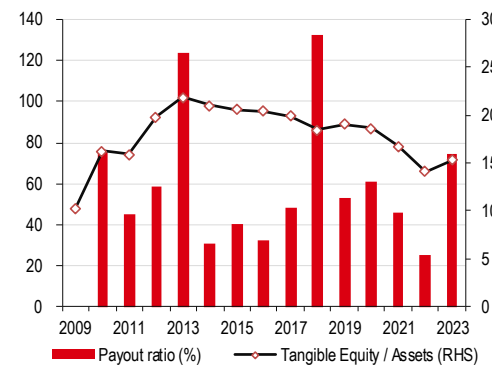
Source: Company data

Qualitas: Profitability (%)



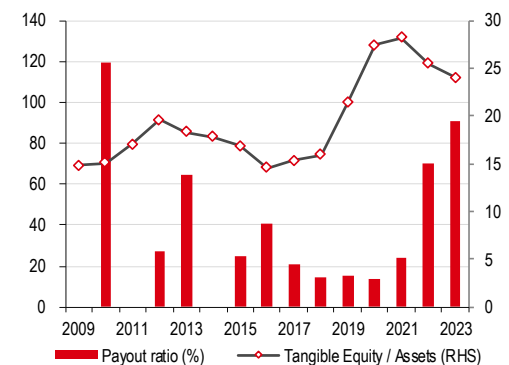
Source: Company data

Porto Seguro: Capital and payout (%)

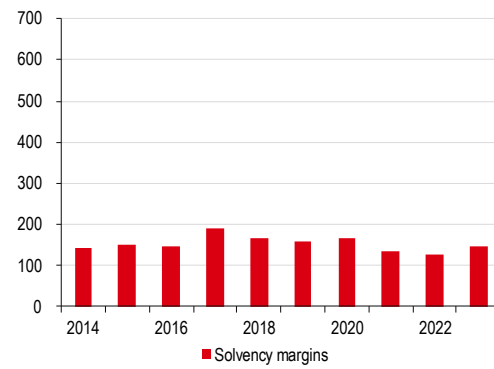


Source: Company data

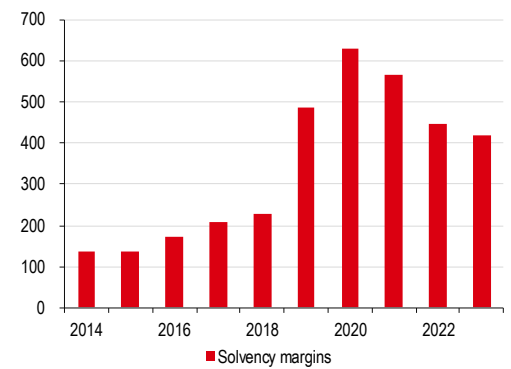
Qualitas: Capital and payout (%)



Source: Company data

Porto Seguro: Solvency margin (%)


Source: Company data

Qualitas: Solvency margin (%)


Source: Company data

ESG credentials

- ◆ We look at the key ESG topics for Porto Seguro and Qualitas
- ◆ Porto is aligned with sustainability principles; corporate governance simplified with only one share class, board has seven members, three of which are independent
- ◆ Environmental parameters for Qualitas have improved since 2019; board is a balanced blend of independence, diversity, and expertise

In recent years, some investors have been incorporating environmental, social, and governance (ESG) considerations into their investment decision-making strategies. The topic covers a wide array of areas from environmental sustainability and social responsibility to corporate governance. In the LatAm Financials space not all ESG topics appear equally relevant. But given the scarcity of truly independent companies, investors naturally pay more attention to corporate governance. In terms of social issues, financial inclusion, financial literacy, and gender pay gaps are very topical, especially in lower income countries. Similarly, environmental aspects are more pertinent in high carbon sectors, but, arguably, they are less relevant to financial companies than they are in other industries.

We briefly look at some of the environmental, social, and governance issues impacting the industry, and Qualitas and Porto Seguro in particular.

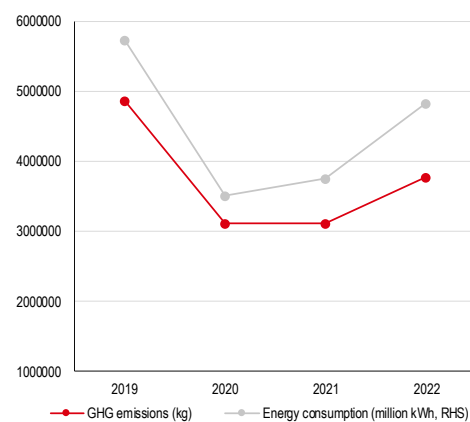
Material ESG topics for Porto Seguro

Environmental (E): Over the last two decades, Porto has maintained a commitment to sustainability, reflecting its broad portfolio of initiatives. The company has been committed to the Insurance Market Sustainability Principles since 2019, joined the Global Compact in 2022, and was recently included in B3's Corporate Sustainability Index. Furthermore, Porto analyzed its performance relating to each of the pillars of its Materiality Matrix, with the support of an external consultancy. The company is currently in the process of establishing a baseline, with metrics and strategic indicators, that will enable it to set clear goals and establish its 2030 ambition. Porto is committed to ensuring that its goals are ambitious, achievable, and aligned with the sustainability principles that guide its operations. Renova Ecopeças, a subsidiary of Porto for recycled and reused car parts, has dismantled over 21,000 vehicles, sold 400,000 items, and disposed of 78,000 tons of steel, 35,000 batteries, and 160,000 tires in an eco-friendly manner.

Social (S): On the social side, Porto launched a diversity and inclusion program called Juntos in 2020 to promote the agenda and practices of diversity and inclusion at the company. As of Dec 2022, women represent c58% of Porto's total workforce and 44% of leadership positions. Porto also has a committee made up of directors and managers to accelerate its agenda, in addition to having affinity groups to support equality regardless of gender, race, ethnicity, LGBTQIAP+, or disability.

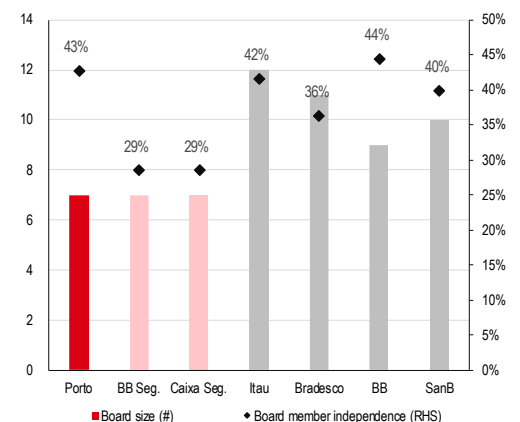
Governance (G): We think one good way of assessing the level of ESG risk is by analyzing its board strength, particularly focusing on the number of board members and the proportion of independent members. Porto's board is composed of 7 members (vs c10 or above for other financial institutions), a positive for decision making, but only three members are independent and there is only one female board member. The board of directors also participate in separate committees, which include Corporate Finance Committee, People and Culture Committee, Sustainability Committee, and Risk Committee. On a positive note, we also highlight that unlike some financial institutions that have multiple share classes with different economic and voting rights, Porto has only one share class with equal voting shares. Each share carries one vote and gives minority shareholders 100% tag-along rights if a change of control occurs.

Energy consumption intensity and GHG emissions



Source: Company data

Board size and independence (2022)



Source: Company data

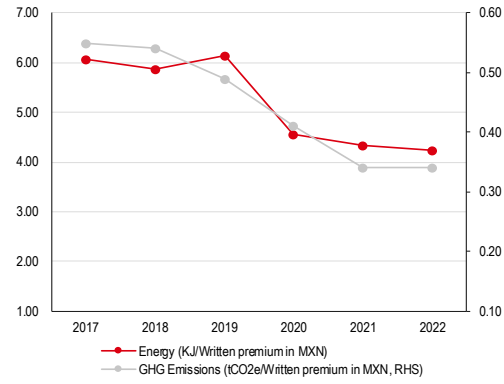
Material ESG topics for Qualitas

Environmental (E): Over the years, Qualitas has made significant progress in reducing its emissions intensity and lowering energy consumption. The company has implemented several crucial initiatives for its direct operations, including: (1) using technology for express claim settlement, which eliminates the need for claims officers to travel; (2) incorporating hybrid vehicles into Qualicoches (vehicle fleets) to reduce gasoline consumption; and (3) installing solar panels at Qualitas's administrative offices. The company remains committed to establishing targets for reducing its greenhouse gas emissions. It aims to achieve net zero emissions by 2050. Its sustainable strategy has enabled it to continue being a part of both national and international reference indexes, such as the S&P/BMV Total Mexico ESG Index and Dow Jones Sustainability MILA Pacific Alliance Index.

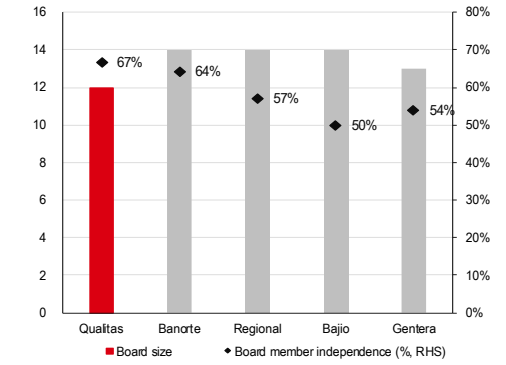
Social (S): On the social side, Qualitas is keenly focused on diversity and equality, while engaging in various social initiatives. As of Dec 2022, women represent c43% of Qualitas's total workforce and hold 37% of key managerial positions. Qualitas Controladora is part of the Bloomberg Gender Equality Index.

Governance (G): The size and composition of the board are key aspects in corporate governance. Qualitas's board comprises 12 members, with 8 independent directors (69%) and two female directors (17%). The board members also participate in separate committees, which include social responsibility and corporate practices, and investment finance and planning.

Energy consumption intensity and GHG emissions



Board size and independence (2022)



Other companies mentioned in this report

Talanax AG (TLX GR, CMP EUR71.60, Hold)

Bradesco Auto (not listed)

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HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price date	Disclosure
PORTO SEGURO	PSSA3.SA	29.38	17 Jun 2024	-
QUALITAS	Q.MX	187.64	17 Jun 2024	-

Source: HSBC

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