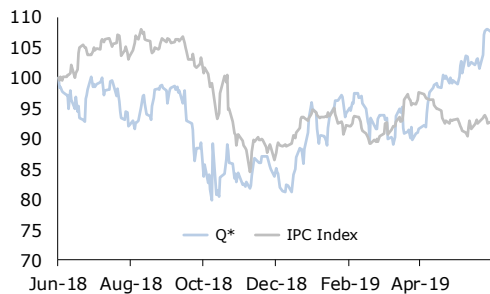


## QUÁLITAS CONTROLADORA, S.A.B. DE C.V.: Initiation of Coverage

### Mexico's Leading Car Insurance Company

HOLD	
2019E Target Price (MXN\$)	\$ 60.00
Current Price (MXN\$)	\$ 55.10
Max / Min (L12M)	\$ 39.75 - 56.21
Expected Dividend (MXN\$)	\$ 0.00
Expected Return	8.9%
Market Cap (MXN\$ Mn)	23,418
Oustanding Shares (Mn)	425.0
Float	43.1%
ADTV (MXN\$ Mn)	\$ 21.10

We are initiating coverage on Quálitas Controladora, S.A.B. of C.V. ("Quálitas"), with a HOLD recommendation and a year-end target price of MXN\$60.0 per share, with a potential 8.9% return. Our recommendation is mainly due to our expectation that Quálitas' performance could be affected during this year by the slowdown in new car sales, and by the normalization of the company's cost and expense structure from the following quarters. We believe that these factors will overshadow the company's solid fundamentals as well as the low valuation of its shares.



### Investment Thesis

**Attractive growth potential after 2020.** We believe that the performance of Quálitas' written premiums will be slow during the current year due to the reduction in new car sales in Mexico. However, we believe that the company's outlook for the next few years is favorable since we expect that its written premiums, operating income and net income will grow at an average annual rate of 6.9%, 15.4% and 8.7%, respectively, in the 2020- 2024 period.

**Leading position in the Mexican car insurance segment.** Quálitas is the country's largest car insurer, holding a 25.9% market share at the end of 1Q19, substantially above Chubb with 12.8% and GNP with 11.8%.

**High profitability.** Quálitas is one of world's most profitable insurers since it recorded a 33.0% ROE during the last twelve months ended in 1Q19.

**Largest distribution network in Mexico.** One of Quálitas' main competitive advantages is its extensive

June 27, 2019

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Report prepared by Miranda Global Research for Vector Casa de Bolsa, S.A. de C.V.

distribution network which includes 178 service offices, 231 ODQ's, and 13,709 non-exclusive agents.

**Management team with a solid track record of value creation.** The management team has helped the company to gain market share almost every year, they have responded well to macroeconomic crises, and they have generated an average annual growth of 14.2%, 15.0%, 41.6% and 21.8% in terms of written premiums, accrued premiums, operating income and net income, respectively, in the 2008-2018 period.

### VALUATION

**Multiples.** Quálitas shares trade at a P/BV of 2.3x and a 2019E P/E of 8.7x. These multiples compare against the averages of 2.1x and 14.4x, respectively, of its counterparts in emerging markets, and 1.2x and 10.7x, respectively, of its comparables in developed markets.

**Target Price.** We established our target price of MXN\$60.0 per share through a Gordon Shapiro model that includes an 11.3% cost of equity (with a Beta of 0.55 vs. IPC), a long-term ROE of 23% (in the upper part of the range expected by the company for the next few years) and a perpetuity growth rate of 2.5% in nominal terms. Our target price implies that Quálitas' shares will operate at a P/BV of 2.3x and a projected P/E of 9.5x at the end of the current year, compared to the averages of 2.4x and 9.3x, respectively, of the past 5 years.

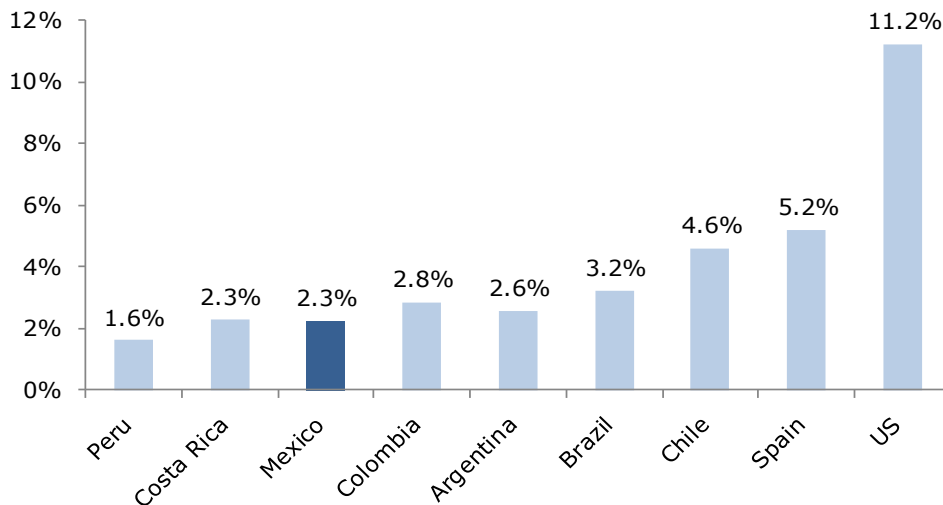
### Main Risks

We believe that Quálitas' main risks are the following: i) intense competition in the auto insurance sector; ii) macroeconomic volatility / slowdown; iii) adverse regulatory and/or fiscal changes; iv) changes in the administrative team; and / or v) diversification into new business segments.

### EXCELLENT OUTLOOK OF THE MEXICAN INSURANCE INDUSTRY

The Mexican insurance market offers significant growth opportunities due to the fact that total premiums represented only 2.25% of GDP in 2017, according to OECD information. This figure is significantly lower than that of other similar countries such as Brazil (3.2%), Chile (4.6%), Colombia (2.9%), and Argentina (2.6%), and is significantly lower than that of developed countries such as the US (11.2%) and Spain (5.2%). According to INEGI, there are 45.5 million vehicles on the road in the country, and we estimate that only 31% of them are insured.

**Graph 1.- Insurance Premiums vs. GDP (2017)**

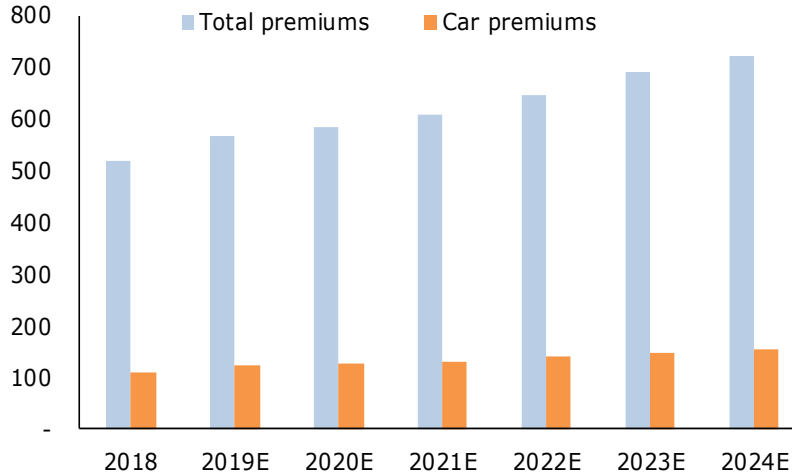


Source: OECD

Total premiums in Mexico were MXN\$518.8 billion in 2018, which represented a 9.8% annual average growth during the last ten years, according to the Mexican Association of Insurance Institutions (AMIS). Car premiums amounted to MXN\$109.9 billion in 2018, which translates into an 8.8% annual average growth.

Conservatively, we estimate that the insurance industry will grow at an average annual rate of 5.7% in the 2019-2024 period, because it comprises a low percentage of GDP. We believe that the penetration of auto insurance will remain stable at around 21.5% of total premiums and that this industry will grow at an average annual rate of 5.9% in the period.

**Graph 2.- Total Premiums and Car Premiums in Mexico (MXN\$ Billions)**



Source: AMIS, Miranda Global Research

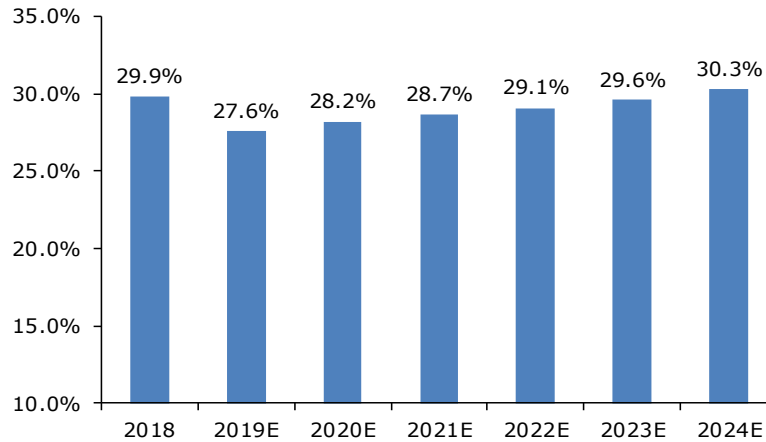
## **QUÁLITAS' MAIN COMPETITIVE ADVANTAGES**

### **Leading Position in the Mexican Car Insurance Sector, Despite Recent Market Loss**

Quálitas is Mexico's largest auto insurance company, with a 25.9% market share at the end of 1Q19. Since it was founded, the company has gained market share by taking advantage of its knowledge of the sector, its wide distribution network, its customer service and its cutting-edge technology. We believe that this trend will continue going forward.

It is important to mention that Quálitas lost some market share during the last reported quarter. We believe that this was due mainly to a greater competition from the five largest insurance companies, delayed payments and budget cuts by the federal government and the fact that Quálitas avoided unprofitable contracts. We believe that this indicator will stabilize during the coming quarters and that it will begin to increase again towards the end of the current year. We expect it to remain on the rise for the next few years, reaching 30.3% in 2024, according to our estimates.

**Graph 3.- Quálitas' Market Share (2018 – 2024E)**

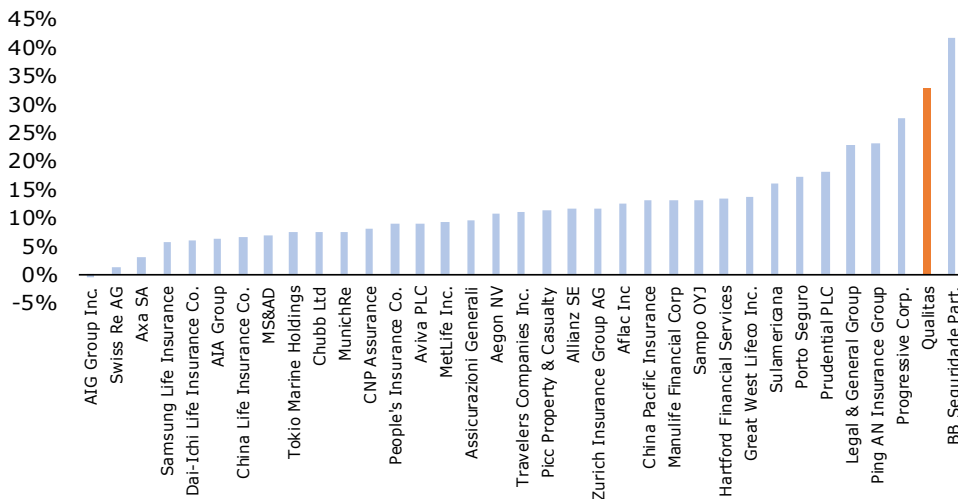


Source: AMIS, Miranda Global Research

**High Profitability**

Quálitas is one of the world's most profitable insurers with a 33.0% ROE in the last twelve months ended in 1Q19. We believe that the company's high profitability is due its extensive knowledge of the automotive segment, its focus on efficient customer service, its cutting-edge technology, its wide distribution network, its vertical integration and its continued reduction of costs and expenses.

**Graph 4.- ROE of International Insurance Companies (1Q19)**

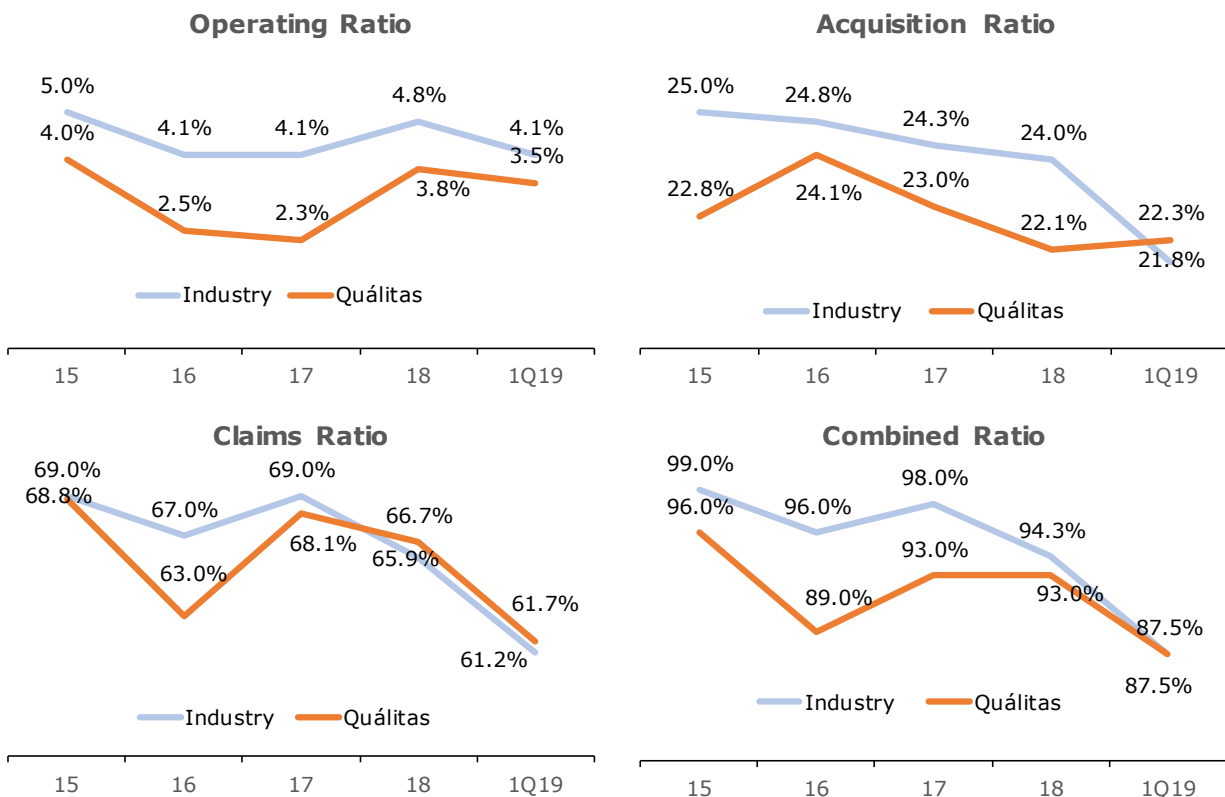


Source: Bloomberg

## QUÁLITAS: Initiation of Coverage

If we compare Quálitas with its Mexican counterparts, we can see that its high profitability is a result of its slightly lower ratios (acquisition, claims, operating and combined in general). It is also due to the fact that Quálitas generates more financial income as a percentage of the operating result than its national competitors. The company focuses on its two main businesses (operating and financial) in a separate way, looking to generate the highest returns in each of them.

**Graph 5.- Main Operational Indicators, Quálitas vs. Mexican Car Insurers**



Source: AMIS

### The Largest Distribution Network in Mexico / State-of-the-Art Technology

One of Quálitas' main competitive advantages is its extensive distribution network with 178 service offices, 231 ODQ's (Quálitas' Office-in-Development) and 13,709 non- exclusive agents. Quálitas is a company with decentralized decision making according to the needs of each individual service office.

Quálitas also has state-of-the-art technology, which helps the company to be aware of the client's needs and to generate high profitability levels. The company uses artificial intelligence

## QUÁLITAS: Initiation of Coverage

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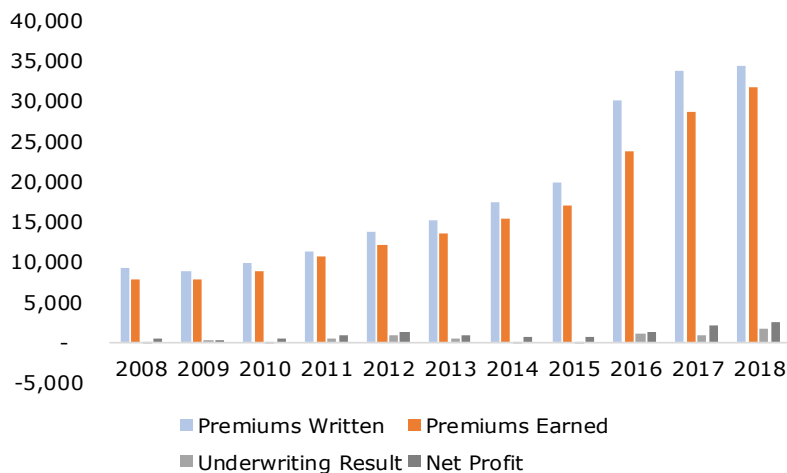
and robots in some of its processes in order to optimize response times and be more efficient operatively speaking.

### Management Team with a Solid Track Record of Value Creation

We have a positive opinion of Quálitas' management team due to its extensive knowledge of the car insurance market. The management team has helped the company to gain market share almost every year, they have responded well to macroeconomic crises, and they have generated an average annual growth of 14.2%, 15.0%, 41.6% and 21.8% in terms of written premiums, accrued premiums, operating income and net income, respectively, in the 2008-2018 period.

Mr. Brockman is a member of a family who has been in the insurance industry for more than fifty years. Wilfrido Castillo, whom we have known for around 25 years, has been the CEO of several brokerages. Quálitas CEO, José Antonio Correa, has been in that position since January 2018 and was previously the CFO of the company for 3 years. He has worked in the financial area for major multinational companies, such as Seguros Monterrey New York Life and P&G, since 1979. The CFO, Bernardo Rissoul, started working at Quálitas in January this year. He has 18 years of experience in international companies.

**Graph 6.- Quálitas' Written Premiums, Earned Premiums, Operating Profit, and Net Profit of (2009 – 2018, MXN\$ Mn)**



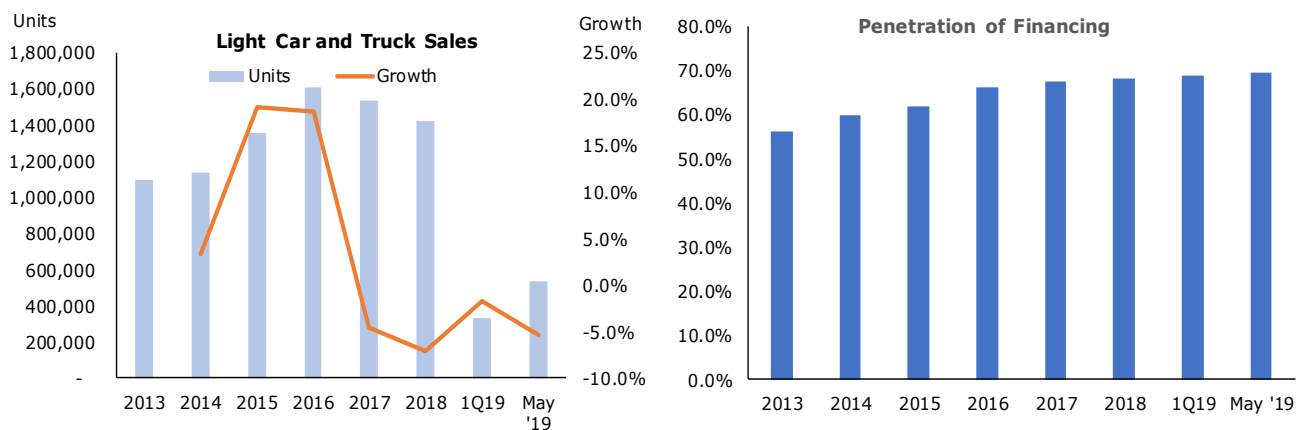
Source: Quálitas

**FAVORABLE GROWTH AND STABILIZED COST STRUCTURE TOWARDS THE END OF THE CURRENT YEAR**

We estimate that 19% of the premiums written by Quálitas in Mexico depend on the sales of new light cars, which have been decreasing since 2017 due to internal macroeconomic issues and international financial volatility.

We believe that the sales of light cars will fall this year by around 5%, taking into account a macroeconomic growth of 1.32% according to Banco de México's last survey. We expect them to rebound 6% in 2020 and grow at a compound annual rate of 7% from that year forward, if of Mexico's economy's performance improves.

**Graph 7.- Sales of Light Cars and Trucks in Mexico (2013 – May 2019)**



Source: AMIA

This year, we anticipate that Quálitas' premiums written will grow 3%, mainly due to the weakness of 1Q19, which was affected by Mexico's macroeconomic slowdown and the reduction in new car sales. We anticipate that there will be growth of 16% in the individual segment and 14% in fleets, which will be partially offset by the 16% drop in the financial sector, due to Quálitas' strategy to pay fewer commissions, and a 40% decline in the "other" segment.

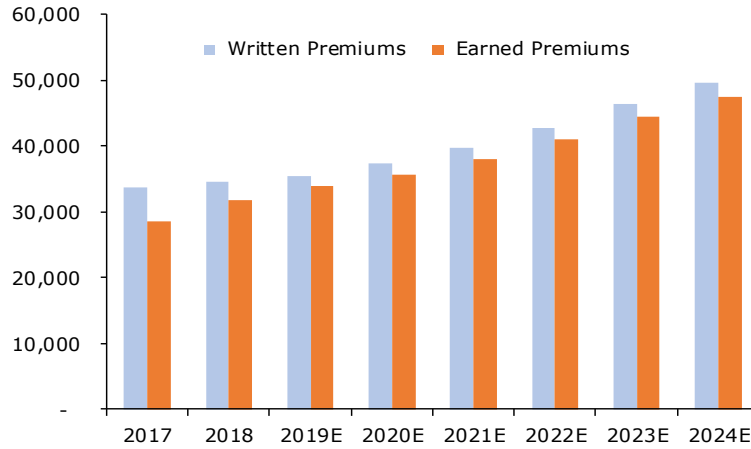
In the years following, we estimate that Quálitas will gain market share and that written premiums will grow at a 7% compound annual rate due to the low percentage of GDP that is spent on the insurance market. By segment, we project that premiums issued in fleets will grow at an average annual rate of 15% and that those in the individual segment will rise at an average annual rate of 11%. We also estimate that the premiums issued in the foreign and other segments will increase at a compound annual rate of 8% and 7%, respectively. On the other hand, we believe that premiums of the financial segment will continue to decrease at an average annual rate of 14%.



## QUÁLITAS: Initiation of Coverage

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**Graph 8.- Quálitas' Written and Earned Premiums (2018 – 2024E, MXN\$ Mn)**



Source: BMV, Miranda Global Research

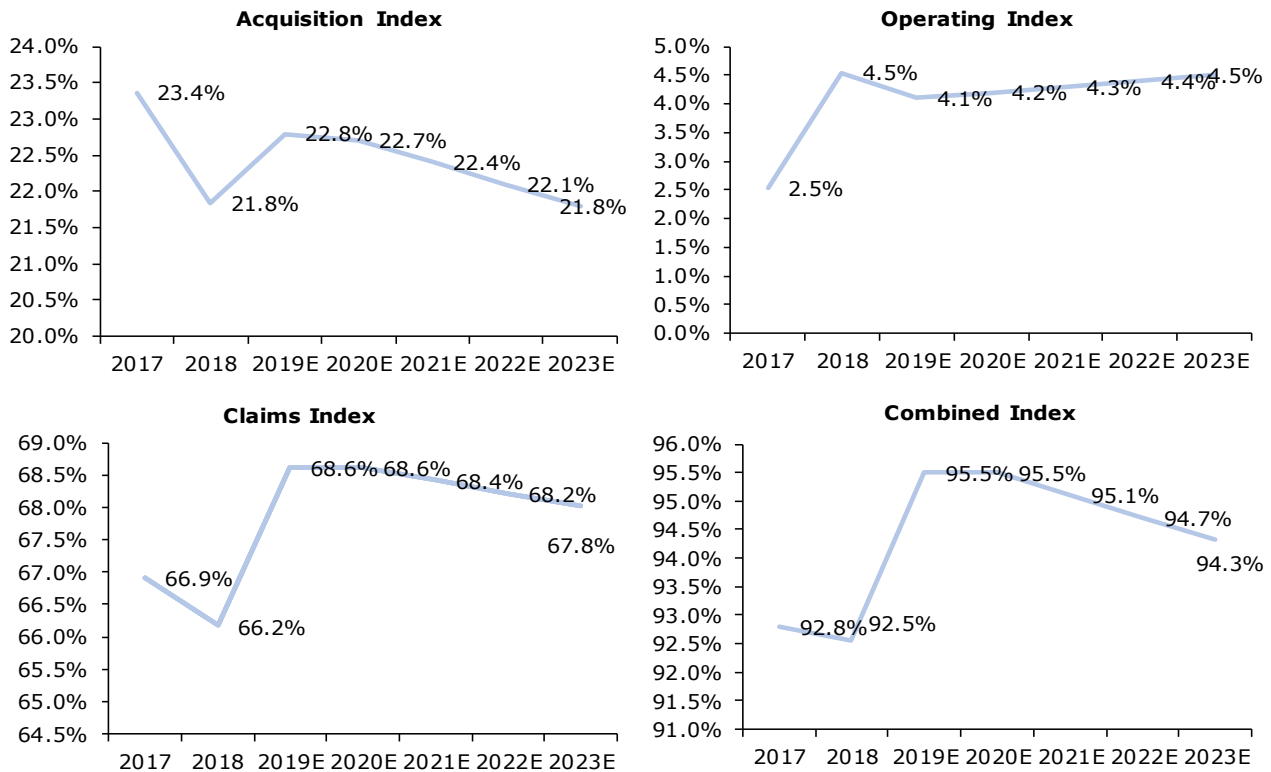
We anticipate that Quálitas' acquisition index will rise to 22.8% in 2019 (from 21.8% in 2018) due to higher administrative expenses, offset by lower commissions paid in the financial institutions segment. However, we expect this index to gradually fall to 21.5% in 2024 due to economies of scale, as well as to the continued reduction of commissions paid in the financial segment.

The claims ratio will be 68.6% in 2019 (compared to 66.2% in 2018). 1Q19 was a favorable quarter for the company due to a lower number of claims and a reduction in thefts, both nationally and in automobiles insured by Quálitas. In addition, there was a shortage of gasoline as the Federal Government's fought against the theft of such product. However, we are taking a conservative stance for the rest of the year as we anticipate spikes in the number of claims and thefts. We project that this index will remain at 68.6% in 2020 and that it will gradually improve to 67.8% in 2024 due to economies of scale in the purchase of spare parts and a higher percentage of recoveries.

The operating ratio will be 4.1% during the current year and will rise gradually to reach 4.6% in 2024 due to the opening of more branches and the hiring of more sales personnel.

As a result, we believe that the combined index will be 95.5% (adjusted for 96.5%) in 2019, higher than the 92.5% (adjusted for 94.6%) of the previous year, and that it will remain stable in 2020. The combined index will gradually fall to 93.9% (adjusted of 94.9%) in 2024, again due to economies of scale.

**Graph 9.- Quálitas' Ratios (2018 – 2024E)**



Source: AMIS, Miranda Global Research

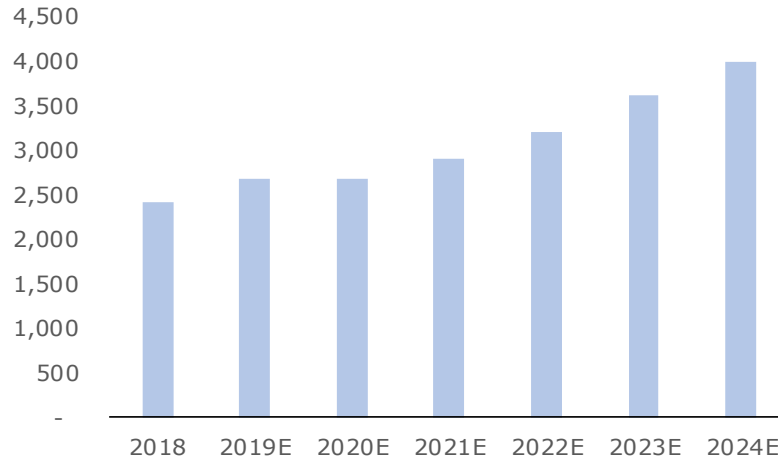
In terms of financial income, we anticipate that Quálitas will generate a return practically in line with Banco de Mexico's reference rate. This rate currently stands at 8.25%, but we expect it to gradually begin to fall from the following quarters due to the macroeconomic slowdown. We believe that it will reach 7.25% by the end of 2021 and that it will remain at those levels for the next few years. It is important to mention that the company's strategy is to increase its exposure to long-term bonds in order to take advantage of the expected reduction in interest rates.

We project that the Quálitas' net income after minority interests will reach MXN\$2.6 billion in 2019, with a 10% growth. It will rise slightly to MXN\$2.7 billion in 2020 and will reach MXN\$4.0 billion in 2024 due to the continuous improvement in the company's cost and expenses structure.

## QUÁLITAS: Initiation of Coverage

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**Graph 10.- Quálitas' Net Profit (2018 – 2024E, MXN\$ Mn)**



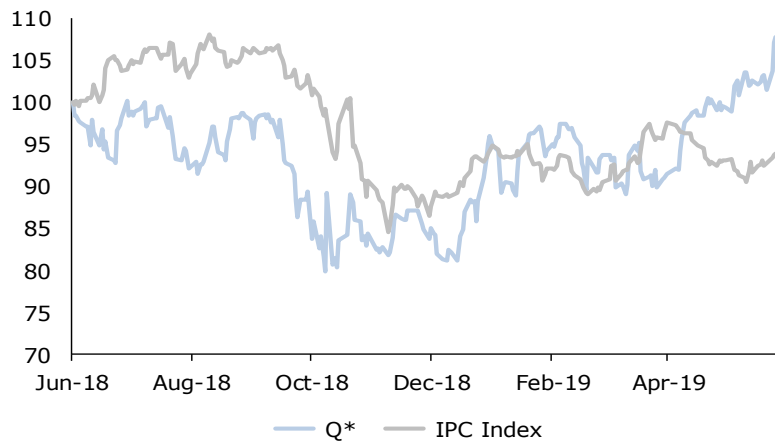
Source: BMV, Miranda Global Research

## VALUATION

### Performance vs. IPC Index

Quálitas' shares have outperformed the IPC Index during the last twelve months. It is worth mentioning that they have rallied 35.7% since the end of 2018. However, we expect them to perform more in line with the IPC Index in the medium term due to the slowdown in sales of new cars in Mexico.

**Graph 11.- Performance of Q\* vs. IPC**



Source: Bloomberg

## QUÁLITAS: Initiation of Coverage

### Global Comparables

Qualitas shares trade at a P/BV of 2.3x and a 2019E P/E of 8.7x. These multiples compare against the averages of 2.1x and 14.4x, respectively, of its counterparts in emerging markets, and 1.2x and 10.7x, respectively, of its comparables in developed markets, as can be seen in our global valuation table.

**Table 1.- Valuation of International Insurance Companies**

Company	Country	Price	Market	P/E			P / BV	ROE	3-year	Div.
		(USD)		2019E	2020E	2021E				
<i>Emerging Markets</i>										
Qualitas	Mexico	\$ 2.88	1,252	8.7x	8.7x	8.0x	2.3	33.0	6%	1.5
China Life Insurance Co.	Hong Kong	\$ 2.42	102,805	18.9x	18.2x	16.8x	2.2	6.7	52%	1.0
Ping AN Insurance Group	Hong Kong	\$ 11.94	225,031	11.7x	10.2x	8.8x	2.3	23.1	16%	2.1
AIA Group	Hong Kong	\$ 10.58	127,885	19.8x	17.3x	15.1x	3.2	6.4	48%	1.4
China Pacific Insurance	China	\$ 5.26	43,978	13.4x	11.7x	10.1x	2.0	13.0	17%	2.8
BB Seguridade Part.	Brazil	\$ 8.44	16,894	17.2x	15.8x	14.5x	9.6	41.7	6%	4.2
People's Insurance Co. Group of Chin	Hong Kong	\$ 0.39	52,056	21.2x	19.4x	17.6x	1.7	8.9	15%	1.7
Samsung Life Insurance	South Korea	\$ 72.48	14,486	13.1x	12.7x	12.2x	0.5	5.8	(8%)	3.2
Picc Property & Casualty	Hong Kong	\$ 1.04	23,247	8.0x	7.2x	6.6x	1.1	11.3	15%	3.8
Porto Seguro	Brazil	\$ 13.63	4,407	12.7x	11.6x	10.4x	2.2	17.4	6%	1.5
Sulamericana	Brazil	\$ 9.16	3,612	13.8x	12.0x	10.5x	2.2	16.1	11%	0.6
<b>Total /Average Emerging Markets</b>			<b>615,654</b>	<b>14.4x</b>	<b>12.9x</b>	<b>11.3x</b>	<b>2.1</b>	<b>16.7</b>	<b>21%</b>	<b>2.4</b>
<i>Developed Markets</i>										
Allianz SE	Germany	\$ 241.55	102,624	11.4x	10.8x	10.3x	1.4	11.5	4%	4.2
AIG Group Inc.	US	\$ 52.26	45,453	10.9x	10.4x	10.0x	0.8	(0.5)	n.a.	2.4
Prudential PLC	UK	\$ 21.31	55,426	10.6x	9.8x	9.2x	2.5	18.1	14%	2.9
Axa SA	France	\$ 26.33	63,891	8.6x	8.0x	7.8x	0.8	3.2	48%	5.8
MetLife Inc.	US	\$ 48.87	46,445	8.8x	8.3x	8.0x	0.9	9.3	4%	3.6
Zurich Insurance Group AG	Switzerland	\$ 347.95	52,069	12.7x	11.7x	11.0x	1.6	11.7	8%	5.6
Chubb Ltd	US	\$ 147.00	67,307	14.2x	13.1x	12.5x	1.3	7.6	0.1x	2.0
MunichRe	Germany	\$ 254.18	36,716	12.7x	11.5x	11.0x	1.2	7.6	7%	4.1
Travelers Companies Inc.	US	\$ 148.70	38,946	13.3x	12.9x	12.9x	1.7	11.1	6%	2.2
Allstate	US	\$ 31.46	13,995	6.2x	5.7x	5.6x	(82.8)	n.a.	21%	1.3
Manulife Financial Corp	Canada	\$ 18.13	35,710	8.3x	7.8x	7.3x	1.0	13.1	10%	4.2
Swiss Re AG	Switzerland	\$ 101.37	34,333	14.5x	12.5x	12.3x	1.2	1.4	82%	5.7
Assicurazioni Generali	Italy	\$ 18.83	29,587	10.2x	9.9x	9.5x	1.0	9.5	5%	5.4
Sampo OYJ	Finland	\$ 47.42	26,361	15.1x	14.6x	14.3x	1.8	13.2	(2%)	6.8
Aflac Inc	US	\$ 54.24	40,434	12.6x	12.6x	12.1x	1.7	12.4	5%	2.0
Tokio Marine Holdings Holdings	Japan	\$ 49.70	35,312	11.4x	11.3x	11.3x	1.1	7.4	8%	3.5
Great West Lifeco Inc.	Canada	\$ 22.84	21,213	10.0x	9.4x	8.5x	1.1	13.6	1%	5.5
Legal & General Group	UK	\$ 3.41	20,316	7.9x	8.8x	8.8x	1.8	22.7	(2%)	6.1
Aviva PLC	UK	\$ 5.26	20,600	7.9x	7.2x	7.0x	0.9	9.0	12%	7.2
Hartford Financial Services	US	\$ 54.88	19,839	10.4x	10.1x	9.8x	1.5	13.5	4%	2.2
Dai-Ichi Life Insurance Co.	Japan	\$ 14.69	17,616	8.1x	7.9x	7.5x	0.5	6.0	5%	3.9
Aegon NV	Netherlands	\$ 4.89	10,324	6.4x	5.7x	6.0x	0.4	10.8	25%	6.7
MS&AD Insurance Group Holdings	Japan	\$ 31.73	18,840	9.6x	9.4x	9.1x	0.8	6.8	6%	4.4
Progressive Corp.	US	\$ 78.59	45,904	14.5x	14.0x	12.6x	4.2	27.5	12%	0.5
CNP Assurance	France	\$ 22.57	15,514	9.9x	9.4x	9.2x	0.7	8.1	2%	4.5
<b>Total /Developed Markets</b>			<b>914,775</b>	<b>10.7x</b>	<b>10.2x</b>	<b>9.7x</b>	<b>1.2</b>	<b>12.5</b>	<b>12%</b>	<b>3.5</b>

Source: Bloomberg, Miranda Global Research

## QUÁLITAS: Initiation of Coverage

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### Gordon Shapiro Model / Target Price

We established our target price of MXN\$60.0 per share through a Gordon Shapiro model that includes an 11.3% cost of equity (with a Beta of 0.55), a long-term ROE of 23% (in the upper part of the range that the company projects for the next few years) and a 2.5% perpetuity growth rate in nominal terms. The potential return is 8.9% against the current market price.

**Table 2.- Gordon Shapiro Model (MXN\$ Mn)**

Stockholder's Equity 2019E	10,929
Long-Term ROE	23.0%
<b>Cost of Equity</b>	<b>11.3%</b>
Risk-Free Rate	8.0%
Market Risk Premium	6.0%
Beta	0.550
<b>Long-Term Growth Rate</b>	<b>2.5%</b>
Equity Value	25,501
Outstanding Shares	425
Target Price / Share	\$ 60.00
Current Price / Share	\$ 55.10
Expected Dividend	\$ -
<b>Total Return</b>	<b>8.9%</b>
Target P/BV	2.3x
Target P/E (Forward)	9.5x

Source: Miranda Global Research

### Sensitivity Analysis

We carried out a sensitivity analysis of our target price depending on different levels of net income, stockholders' equity and multiples. We believe that our target price is easily achievable since it implies that Quálitas' shares will trade at a P/BV of 2.3x and an estimated P/E of 9.5x at the end of the current year, which compare against the averages of 2.4x and of 9.3x, respectively, of the last five years.

**Table 3.- Target Price Sensitivity Analysis (P/BV vs. Book Value)**

	-10%	-5%	<i>Original</i>	+5%	+10%
<b>Stockholder's Equity</b>	<b>9,864</b>	<b>10,383</b>	<b>10,929</b>	<b>11,476</b>	<b>12,049</b>
<b>Target P/BV</b>					
0.8x	19.34	20.36	21.43	22.50	23.63
1.3x	30.94	32.57	34.29	36.00	37.80
1.8x	42.55	44.79	47.15	49.50	51.98
<b>2.3x</b>	<b>54.15</b>	<b>57.00</b>	<b>60.00</b>	<b>63.00</b>	<b>66.15</b>
2.8x	65.76	69.22	72.86	76.50	80.33
3.3x	77.36	81.43	85.72	90.00	94.51

Source: Miranda Global Research

## QUÁLITAS: Initiation of Coverage

**Table 4.- Target Price Sensitivity Analysis (P/E Estimate vs. Projected Net Profit)**

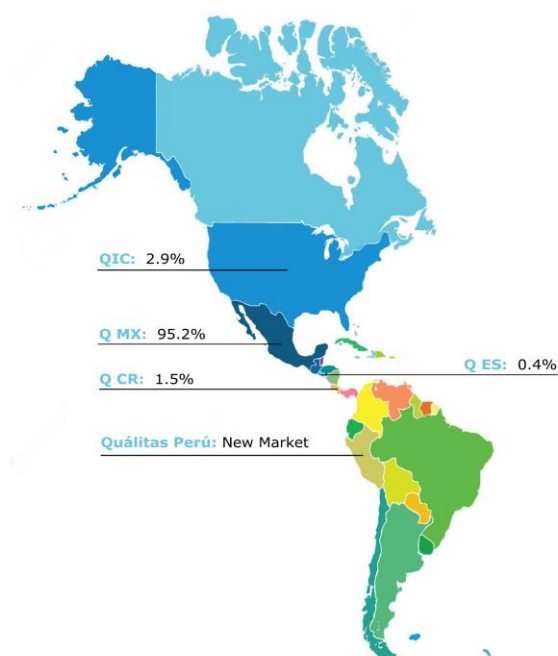
	-10%	-5%	<i>Original</i>	+5%	+10%
<b>Projected Net Profit</b>	<b>2,429</b>	<b>2,557</b>	<b>2,691</b>	<b>2,826</b>	<b>2,967</b>
<b>Target P/E</b>					
6.5x	37.01	38.96	41.01	43.06	45.21
7.5x	42.72	44.97	47.34	49.71	52.19
8.5x	48.44	50.99	53.67	56.35	59.17
<b>9.5x</b>	<b>54.15</b>	<b>57.00</b>	<b>60.00</b>	<b>63.00</b>	<b>66.15</b>
10.5x	59.87	63.02	66.34	69.65	73.14
11.5x	65.58	69.03	72.67	76.30	80.12

Source: Miranda Global Research

## COMPANY DESCRIPTION

Quálitas Controladora, S.A.B. de C.V., is a Mexican holding company which owns insurance companies and various related businesses. Its main subsidiary is Quálitas Mexico, the country's largest car insurer. Other subsidiaries that provide insurance services are Quálitas Costa Rica, Quálitas El Salvador, Quálitas Insurance Company and Quálitas Perú. The subsidiaries that sell auto parts are Outlet de Refacciones, Easy Car Glass and CristaFácil. In 1Q19, Quálitas recorded written premiums of MXN\$8.4 billion, earned premiums of MXN\$8.1 billion, technical result of MXN\$1.3 billion, net result of MXN\$1.2 billion and L12M ROE of 33.0%. Quálitas was founded in Mexico City in December 1993.

**Graph 12.- Quálitas's Geographic Coverage**



Source: Quálitas

## QUÁLITAS: Initiation of Coverage

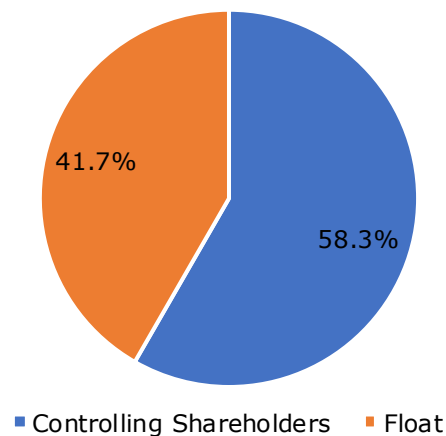
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### Ownership Structure / Share Data

Quálitas' capital is represented by 425 million registered ordinary, single series shares, corresponding to its fixed capital. The company canceled 10 million shares at its annual meeting which took place on April 19. The control group owns 57.0% of the outstanding shares. The remaining 43.1% is the float.

We believe that Quálitas' shares have high liquidity since the average daily traded value was MXN\$21.1 million during the last six months. The stock is in the 45<sup>th</sup> position of the Mexican Bolsa's liquidity index.

**Graph 13.- Quálitas's Ownership Structure**



Source: Quálitas

### Corporate Governance

We believe that Quálitas' corporate governance is solid. The Board of Directors includes 13 members, of which 8 are independent, above the required minimum of 25% in accordance with the Securities Market Law. In addition, the company has four committees: Audit and Corporate Practices, Investment, Finance and Planning, Social Responsibility and Operations.

**Table 5.- Quálitas' Board of Directors**

Joaquín Brockman Lozano	Chairman
Wilfrido Javier Castillo Sánchez Mejorada	Vice-President
José Antonio Correa Echegaray	Related
Wilfrido Javier Castillo Miranda Olea	Related
María del Pilar Moreno Alanís	Related
Juan Orozco y Gómez Portugal	Independent
Juan Enrique Murguía Pozzi	Independent
Mauricio Domenge Gaudry	Independent
Christian Alejandro Pedemonte del Castillo	Independent
Juan Marco Gutiérrez Wanless	Independent
Madeleine Marthe Claude Brémond Santacruz	Independent
José Manuel Rincón Gallardo Purón	Independent
Alfonso Tomás Lebrija Guiot	Independent

Source: 2019 Annual Shareholder's Meeting Resolutions

### Dividends / Buy-Back Reserve

Quálitas seeks to maintain a ratio of capital to minimum regulatory capital of 1.5x. The dividend policy includes the payment of 50-90% of the surplus, depending on the company's capital needs for future projects. At the annual meeting held on April 22<sup>nd</sup>, the company approved the payment of an MXN\$0.85 per share cash dividend, effective May 10<sup>th</sup>. The yield was 1.7% compared to the price of that date. We talked to the company and they discarded the payment of extraordinary dividends for the rest of this year. On the other hand, the shareholders approved a share repurchase reserve of MXN\$650 million, which can reach up to MXN\$700 million.

**Table 6.- Quálitas's Historical Dividends**

Year	Div. Per Share or CPO (MXN\$)	Amount (MXN\$ Mn)
2010	\$ 0.40	\$ 180
2011	n.a.	n.a.
2012	\$ 0.50	\$ 225
2013	\$ 1.50	\$ 675
2014	n.a.	n.a.
2015	n.a.	n.a.
2016	\$ 0.50	\$ 225
2017	\$ 0.60	\$ 270
2018	\$ 0.70	\$ 305
2019	\$ 0.85	\$ 361

Source: Quálitas



## QUÁLITAS: Initiation of Coverage

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### 1Q19 Results

Written premiums decreased -7.3% YoY in 1Q19, to MXN\$8.4 billion. This performance was mainly due to a 26.4% YoY reduction in the financial institutions segment, given the company's strategy to reduce its dependence on that sector and improve its profitability. Quálitas also registered a 4.8% YoY fall in fleets and a 45.2% YoY reduction in "others". This was partially offset by increases of 18.6% in the individual segment and 3.0% in financial institutions. It is worth mentioning that, in Mexico, Quálitas' market share was 25.9% in the quarter, below last year's share of 29.9%.

**Table 7.- Premiums Issued by Segment (MXN\$ Mn)**

Segment	1Q19	1Q18	Δ %
Individual	2,726	2,298	18.6%
Fleets	2,611	2,742	-4.8%
Financial Institutions	2,616	3,557	-26.5%
Foreign subsidiaries	401	390	2.8%
Other	33	60	-45.0%
<b>Total</b>	<b>8,387</b>	<b>9,047</b>	<b>-7.3%</b>

Source: Quálitas

On the other hand, premiums earned were MXN\$8.0 billion, with an annual increase of 4.8%. Quálitas' market share in terms of earned premiums was 30.3% in 1Q19, compared to 31.6% in 4Q18.

Insured units by Quálitas rose 2.0% YoY, reaching 3.97 million. El Salvador's and the United States' operations were the main drivers with increases of 29.7% and 14.2%, respectively. In addition, the company presented an 11.6% growth in "tourists", +10.8% in motorcycles and +5.5% in trucks. On the other hand, the number of auto insurances decreased 0.2%.

The number of Quálitas insured vehicles in Mexico rose 1.8% YoY, which compares favorably with the 1.6% drop in the number of new vehicles sold in the country.

**Table 8.- Type of Insured Vehicles**

Segment	1Q19	1Q18	Δ %
Cars	2,647,162	2,652,194	-0.2%
Trucks	1,034,972	981,233	5.5%
Tourists	78,317	70,191	11.6%
Motorcycles	122,883	110,871	10.8%
El Salvador	17,710	13,650	29.7%
Costa Rica	52,479	49,248	6.6%
USA	17,255	15,114	14.2%
<b>Insured Vehicles</b>	<b>3,970,778</b>	<b>3,892,501</b>	<b>2.0%</b>

Source: Quálitas

## QUÁLITAS: Initiation of Coverage

Quálitas' acquisition index improved by 70 bp to 22.1% in 1Q19 due to lower commissions paid to the financial sector, as well as lower administrative costs. The loss ratio fell 240 bps to 60.9% due to fewer claims as a result of gasoline shortages, a reduction in the number of thefts and a higher recovery rate for the company.

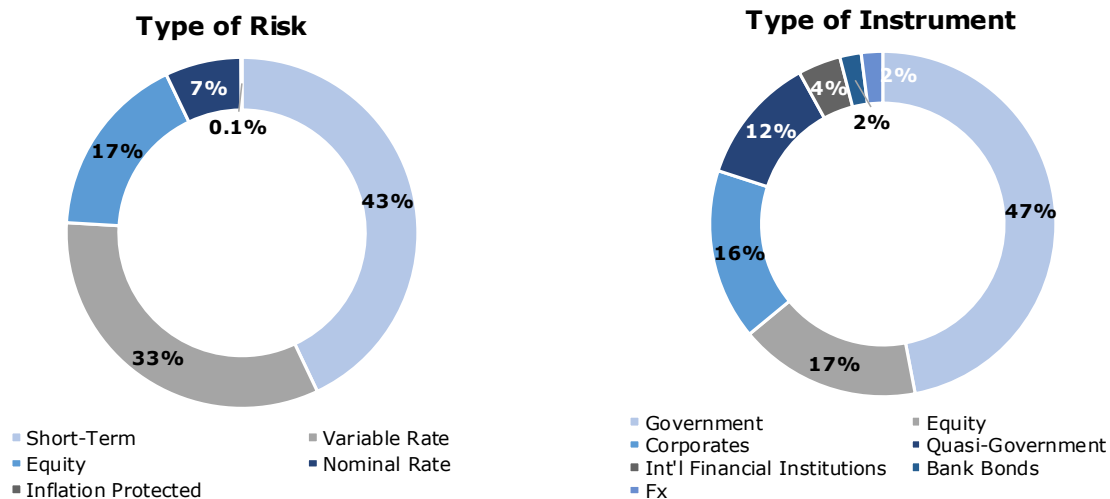
The operating index fell 50 pbs to 4.1% largely due to an extraordinary MXN\$185 million gain related to the release of an income tax reserve. This resulted in an 87.1% combined ratio (adjusted of 88.2%) in 1Q19, which is lower than the 90.7% (adjusted of 95.1%) reported in 1Q18.

Because of the significant reduction in the combined ratio, the technical result grew 63.3% YoY, while the operating result was up 152.2% YoY.

The integral result of financing increased 39.1% YoY to MXN\$681 million. The return on investment was 7.7%, lower than Banco de Mexico's 8.25% reference rate. The debt portfolio recorded a good performance since it is made up of short-term instruments, according to the company. The proportion of the equity portfolio was 18% of the total portfolio, complying with the internally established limit of 35%.

The net result (before minority interests) advanced 102.6% YoY to MXN\$1.2 billion due to the strong performance at both an operating and financial level. In addition, the tax rate was 26.8% in 1Q19, below 32.0% in 1Q18. The annualized ROE was 49.3% and the L12M ROE was 33.0%.

**Graph 14.- Breakdown of Quálitas' Investments in 1Q19**



Source: Quálitas

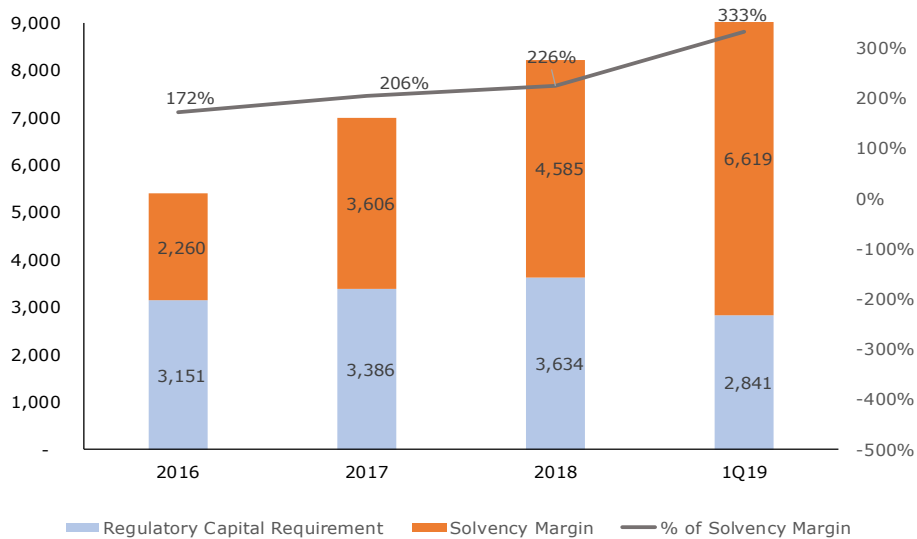
Quálitas presented a 333% solvency index in 1Q19, well above the minimum regulatory level. The company has an excess of capital of more than MXN\$5.1 billion, which will allow it to

## QUÁLITAS: Initiation of Coverage

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continue paying dividends or acquire related business companies. We do not rule out that Quálitas will enter other segments of the Mexican insurance market.

**Graph 15.- Quálitas' Solvency Index as of 1Q19 (MXN\$ Mn)**



Source: Quálitas

### Performance of Quálitas vs. the Industry in 1Q19

Total premiums for the car insurance industry rose 7.3% in 1Q19, according to figures from AMIS. Quálitas' premiums written decreased 7.3% YoY, which reduced the company's market share to 25.9% at the end of 1Q19, compared to 30.1% in 1Q18 and 29.9% in 4Q18. We believe that Quálitas is facing strong pressure from the country's five largest insurance companies since their combined growth was 9.7% in terms of written premiums. In addition, the company experienced certain delays in the renovations of the government segment.

The industry's earned premiums grew 9.8% YoY, while Quálitas' rose 3.9% YoY. The company's market share in terms of earned premiums was 30.3% at the end of 1Q19, compared to 30.1% in 1Q18 and 31.6% in 4Q18. Earned premiums of the five largest car insurers increased 11.6% YoY, also outperforming the industry.

Sales of light cars and trucks in Mexico decreased 1.7% YoY to 332,013 units. Auto loans accounted for 68.8% of the sales of new vehicles, supported by a solid performance of the agencies, as well as the financial arms of the carmakers, while they accounted for 71.1% in 1Q18.

## QUÁLITAS: Initiation of Coverage

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The industry's combined index was 87.5% in 1Q19, down from 91.5% in 1Q18, due to lower loss and acquisition ratios, which happened as a result of the shortage of gasoline at the beginning of the year and lowest sales in the financial institution segment.

The sector's net profit was MXN\$3.7 billion (+ 61.7% YoY) in 1Q19, which included an operating result of nearly MXN\$3.0 billion (+ 99.4% YoY) and financial gains of MXN\$1.9 billion (+28.9% YoY). It is worth mentioning that Quálitas' financial income represented 65% of the company's operating result, compared to the industry average which is 62%.

**Table 9.- 1Q19 Operating Indicators, Mexican Car Insurers**

Company	Operating Result	Investment Income	Net Income	Loss Ratio	Combined Ratio
Quálitas	947	631	1,147	61.7%	87.5%
Chubb	119	153	225	60.4%	90.8%
G.N.P.	329	162	349	60.6%	91.1%
AXA Seguros	516	151	498	57.1%	79.3%
HDI Seguros	73	77	105	60.8%	94.6%
<b>Top 5</b>	<b>1,984</b>	<b>1,174</b>	<b>2,324</b>	<b>60.5%</b>	<b>88.0%</b>
Banorte	218	138	370	67.0%	81.8%
Inbursa	166	40	153	58.7%	87.5%
BBVA	147	169	141	76.3%	83.7%
Zurich Daños	132	16	150	54.8%	88.1%
Mapfre Mexico	(17)	36	25	69.0%	99.1%
Atlas	120	59	175	60.9%	84.2%
Afirme	23	44	52	57.0%	88.6%
ANA	24	22	33	58.0%	89.7%
General de Seguros	(28)	67	28	71.1%	111.3%
SURA	49	9	49	61.1%	87.7%
<b>Medium</b>	<b>835</b>	<b>600</b>	<b>1,178</b>	<b>64.3%</b>	<b>87.3%</b>
<b>Other</b>	<b>178</b>	<b>94</b>	<b>236</b>	<b>52.2%</b>	<b>77.9%</b>
<b>Total Market (34 Companies)*</b>	<b>2,994</b>	<b>1,868</b>	<b>3,738</b>	<b>65.9%</b>	<b>87.5%</b>

Source: AMIS

## MAIN RISKS

**Intense competition in the auto insurance industry.** Quálitas faces intense competition from insurance companies that may be larger, or that are subsidiaries of important financial groups. In Mexico there are 34 insurers and one reinsurer focused on the automotive industry.

**Macroeconomic volatility / slowdown.** The current macroeconomic weakness has impacted the sales of new cars in Mexico, which in turn has affected the sale of new Quálitas premiums. We believe that this situation will likely improve by the end of this year or in early next.

**Adverse regulatory or fiscal changes.** We believe that any adverse regulatory or fiscal changes could have an unfavorable impact on Quálitas' performance and / or prospects. The Mexican insurance industry is highly regulated by several government entities, including the Ministry of Finance and the National Insurance and Bonding Commission.

**Changes in the management team.** Any change in the management team, in particular the CEO, the CFO or the CIO, could affect the performance of Quálitas' share price.

## **QUÁLITAS:** Initiation of Coverage

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**Diversification towards other business segments.** Quálitas plans to diversify into other branches of the Mexican insurance business, which we believe involves some execution risk. However, we fully trust Quálitas' management team.

# QUÁLITAS: Initiation of Coverage

## FINANCIAL PROJECTIONS

INCOME STATEMENT (MXN\$ Mn)	2018	2019E	2020E	2021E	2022E	2023E	2024E	2018	2019E	2020E	2021E	2022E	2023E	2024E
Written Premiums	34,495	35,426	37,295	39,711	42,709	46,433	49,569	2.0%	2.7%	5.3%	6.5%	7.6%	8.7%	6.8%
Ceded	-312	-156	-165	-175	-189	-205	-219	44.4%	-49.9%	5.3%	6.5%	7.6%	8.7%	6.8%
Net Written Premiums	34,183	35,270	37,130	39,536	42,521	46,228	49,350	1.7%	3.2%	5.3%	6.5%	7.6%	8.7%	6.8%
Net Increase of Unearned Premiums Reserve	-2,373	-1,298	-1,366	-1,455	-1,565	-1,701	-1,816	-51.9%	-45.3%	5.3%	6.5%	7.6%	8.7%	6.8%
Earned Premiums	31,810	33,972	35,764	38,081	40,956	44,527	47,534	11.0%	6.8%	5.3%	6.5%	7.6%	8.7%	6.8%
Acquisition Cost	-7,464	-8,040	-8,428	-8,856	-9,397	-10,078	-10,610	-4.9%	7.7%	4.8%	5.1%	6.1%	7.2%	5.3%
Claims Cost	-21,048	-23,308	-24,537	-26,054	-27,939	-30,288	-32,239	9.7%	10.7%	5.3%	6.2%	7.2%	8.4%	6.4%
Technical Income	3,298	2,624	2,798	3,171	3,620	4,161	4,685	101.9%	-20.4%	6.6%	13.3%	14.2%	15.0%	12.6%
Net Operating Expenses	-1,568	-1,451	-1,565	-1,706	-1,877	-2,088	-2,278	83.4%	-7.4%	7.8%	9.0%	10.1%	11.2%	9.1%
Underwriting Result	1,734	1,175	1,234	1,465	1,742	2,074	2,407	122.8%	-32.2%	5.0%	18.7%	18.9%	19.0%	16.1%
Comprehensive Financing Result	1,717	2,520	2,499	2,573	2,719	2,945	3,152	-6.1%	46.8%	-0.8%	3.0%	5.7%	8.3%	7.0%
Pre-Tax Profit	3,451	3,696	3,733	4,038	4,461	5,019	5,559	32.3%	7.1%	1.0%	8.2%	10.5%	12.5%	10.8%
Taxes and Profit Sharing	-1,023	-1,017	-1,040	-1,126	-1,245	-1,400	-1,551	88.1%	-0.6%	2.3%	8.3%	10.5%	12.5%	10.8%
Net Profit Before Minorities	2,428	2,679	2,693	2,912	3,217	3,618	4,008	17.7%	10.3%	0.5%	8.1%	10.5%	12.5%	10.8%
Minority Interest	-3	-1	-1	-2	-2	-2	-2	-65.5%	-45.0%	0.5%	8.1%	10.5%	12.5%	10.8%
Net Profit After Minorities	2,426	2,677	2,691	2,910	3,215	3,616	4,006	18.0%	10.4%	0.5%	8.1%	10.5%	12.5%	10.8%
EPS	\$ 5.48	\$ 6.23	\$ 6.33	\$ 6.85	\$ 7.56	\$ 8.51	\$ 9.43	20.0%	13.6%	1.7%	8.1%	10.5%	12.5%	10.8%
BALANCE SHEET (MXN\$ Mn)	2018	2019E	2020E	2021E	2022E	2023E	2024E	2018	2019E	2020E	2021E	2022E	2023E	2024E
TOTAL ASSETS	56,642	71,495	75,919	78,577	92,827	96,836	107,729	10.9%	26.2%	6.2%	3.5%	18.1%	4.3%	11.2%
Securities and Derivatives	24,180	31,419	33,202	35,804	38,803	42,560	45,612	-0.8%	29.9%	5.7%	7.8%	8.4%	9.7%	7.2%
Securities	24,180	31,419	33,202	35,804	38,803	42,560	45,612	-0.8%	29.9%	5.7%	7.8%	8.4%	9.7%	7.2%
Overnight	3,565	4,358	4,758	5,158	5,558	5,958	6,358	560.5%	22.2%	9.2%	8.4%	7.8%	7.2%	6.7%
Net Loan Portfolio	289	338	338	338	338	338	338	-28.1%	17.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Gross Loan Portfolio	293	338	338	338	338	338	338	-21.8%	15.4%	0.0%	0.0%	0.0%	0.0%	0.0%
Past Due Loans	38	38	38	38	38	38	38	26.0%	-0.3%	0.0%	0.0%	0.0%	0.0%	0.0%
Loan Loss Provisions	-43	-38	-38	-38	-38	-38	-38	1158.1%	-10.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Property (Net)	1,480	1,454	1,478	1,502	1,526	1,550	1,574	4.6%	-1.8%	1.7%	1.6%	1.6%	1.6%	1.5%
Investments Related to Labour Obligations	64	72	80	88	96	104	112	7.2%	11.9%	11.1%	10.0%	9.1%	8.4%	7.7%
Cash and Cash Equivalents	971	1,313	1,713	2,113	2,513	2,913	3,313	30.0%	35.3%	30.5%	23.3%	18.9%	15.9%	13.7%
Debtors	21,234	25,984	27,459	26,187	36,031	34,725	41,148	10.3%	22.4%	5.7%	-4.6%	37.6%	-3.6%	18.5%
Re-Insurers and Re-Bonding Companies	170	129	109	89	69	49	29	91.5%	-24.2%	-15.5%	-18.4%	-22.6%	-29.1%	-41.1%
Permanent Investments	47	194	194	194	194	194	194	-3.8%	316.6%	0.0%	0.0%	0.0%	0.0%	0.0%
Other Assets	4,642	6,235	6,589	7,105	7,701	8,446	9,052	12.2%	34.3%	5.7%	7.8%	8.4%	9.7%	7.2%
TOTAL LIABILITIES	47,537	60,556	63,236	64,005	76,133	77,693	85,821	10.3%	27.4%	4.4%	1.2%	18.9%	2.0%	10.5%
Technical Reserves	36,173	38,924	43,564	45,302	52,296	56,390	63,388	10.1%	7.6%	11.9%	4.0%	15.4%	7.8%	12.4%
Creditors	5,132	13,532	11,114	9,484	13,859	10,377	10,731	9.7%	163.7%	-17.9%	-14.7%	46.1%	-25.1%	3.4%
Re-Insurers and Re-Bonding Companies	137	130	130	130	130	130	130	103.2%	-4.7%	0.0%	0.0%	0.0%	0.0%	0.0%
Other Liabilities	5,861	7,717	8,155	8,793	9,530	10,453	11,202	10.5%	31.7%	5.7%	7.8%	8.4%	9.7%	7.2%
TOTAL CAPITAL	9,104	10,939	12,682	14,572	16,694	19,144	21,907	14.5%	20.2%	15.9%	14.9%	14.6%	14.7%	14.4%
Minority Interest	8	10	12	14	16	18	20	-81.9%	21.5%	15.9%	14.9%	14.6%	14.7%	14.4%
Stockholder's Equity	9,096	10,929	12,670	14,559	16,679	19,126	21,887	15.1%	20.2%	15.9%	14.9%	14.6%	14.7%	14.4%
CASH FLOW STATEMENT (MXN\$ Mn)	2018	2019E	2020E	2021E	2022E	2023E	2024E	2018	2019E	2020E	2021E	2022E	2023E	2024E
Net Profit	2,428	2,679	2,693	2,912	3,217	3,618	4,008	17.7%	10.3%	0.5%	8.1%	10.5%	12.5%	10.8%
Adjustment for Non-Cash Items	4,755	11,088	1,136	-978	10,282	-475	6,265	-28.5%	133.2%	-89.8%	-186.1%	-1150.8%	-104.6%	-1418.4%
Cash Flow from Operations	-5,255	-11,785	-1,717	251	-11,242	-813	-7,868	-33.4%	124.3%	-85.4%	-114.6%	-4584.9%	-92.8%	868.2%
Cash Flow from Investment	-471	-748	-748	-748	-748	-748	-748	-19.5%	58.8%	0.0%	0.0%	0.0%	0.0%	0.0%
Cash Flow from Financing	-1,221	-878	-948	-1,020	-1,093	-1,167	-1,242	456.4%	-28.1%	8.0%	7.6%	7.1%	6.8%	6.4%
Incr. (Decr.) in Cash and Temp. Investments	237	350	408	408	408	408	408	812.2%	47.5%	16.7%	0.0%	0.0%	0.0%	0.0%
FX Impact on Cash and Temp. Investments	-13	-7	-8	-8	-8	-8	-8	-60.8%	-48.2%	18.0%	0.0%	0.0%	0.0%	0.0%
Beginning of Period Cash and Temp. Investments	747	971	1,313	1,713	2,113	2,513	2,913	-1.0%	30.0%	35.3%	30.5%	23.3%	18.9%	15.9%
End of Period Cash and Temp. Investments	971	1,313	1,713	2,113	2,513	2,913	3,313	30.0%	35.3%	30.5%	23.3%	18.9%	15.9%	13.7%
FINANCIAL RATIOS	2018	2019E	2020E	2021E	2022E	2023E	2024E							
Acquisition Ratio	21.8%	22.8%	22.7%	22.4%	22.1%	21.8%	21.5%							
Claims Ratio	66.2%	68.6%	68.6%	68.4%	68.2%	68.0%	67.8%							
Operating Ratio	4.5%	4.1%	4.2%	4.3%	4.4%	4.5%	4.6%							
Combined Ratio	92.5%	95.5%	95.5%	95.1%	94.7%	94.3%	93.9%							
Adjusted Combined Ratio	94.6%	96.5%	96.6%	96.2%	95.7%	95.3%	94.9%							
Underwriting Result	5.5%	3.5%	3.4%	3.8%	4.3%	4.7%	5.1%							
Return on Financial Investments (Annualized)	6.4%	7.9%	6.7%	6.5%	6.3%	6.3%	6.2%							
Tax and Profit Sharing Rate	29.6%	27.5%	27.9%	27.9%	27.9%	27.9%	27.9%							
ROE	28.5%	26.7%	22.8%	21.4%	20.6%	20.2%	19.5%							
ROA	4.5%	4.2%	3.7%	3.8%	3.8%	3.8%	3.9%							

Source: Quálitas, Miranda Global Research

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