

QUÁLITAS: 2Q21 Results

Extraordinary Quarter Due to Normalization of Claims; Upgraded to BUY

Q*	BUY
Target Price (MXN\$)	\$ 120.00
Current Price (MXN\$)	\$ 92.16
Min / Max (L12M)	\$ 82.46 - 117.96
Expected Dividend (MXN\$)	\$ 4.00
Expected Return	34.5%
Market Cap (MXN\$ Mn)	38,062
Oustanding Shares (Mn)	413.0
Float	47.0%
6-month ADTV (MXN\$ Mn)	\$ 110.7

Opinion and Recommendation

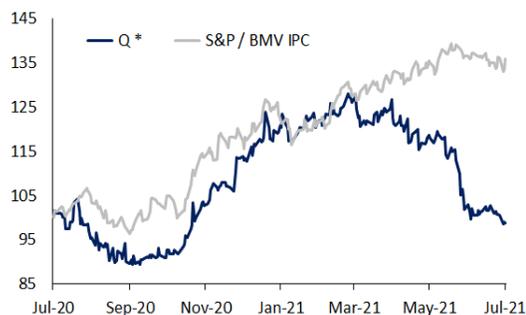
QUÁLITAS reported an atypical quarter with a 56.4% YoY drop in net profits as a result of the normalization of claims and lower financial earnings, which offset the excellent performance in terms of written premiums. The reported figures were above our projections.

After having updated our model, we are raising our recommendation on QUÁLITAS to BUY, from HOLD, and we are adjusting our target price to MXN\$120.0, from MXN\$132.0. We expect another two quarters of normalization in claims. However, we believe that this has been incorporated in the share price, taking into account the sharp decline since mid-March.

In addition, the valuation of QUÁLITAS's shares seems attractive to us since they are currently trading at 10.0x estimated P/E and 2.0x P/BV.

Premiums Written / Earned

Premiums written increased 28.4% (we expected + 23.6%) to MXN\$9.1 billion driven by the significant growth in new car sales (+ 18% accumulated) and gradual price adjustments. According to the company, such adjustments will continue during the second half of the year in order to maintain profitability. By segments, the main drivers were financial institutions (+ 65.9%), foreign subsidiaries (+ 30.7%) and individual (+ 27.9%). This offset the 7.3% drop in fleets. 74.2% of the portfolio included annual policies, which gives the company more flexibility to adjust prices, while the remaining 25.8% are multi-year policies. International subsidiaries represented 10.2% of total premiums, which is the historical high level.



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Premiums earned were up 4.5% YoY (vs. the 2.7% drop we estimated) to MXN\$9.2 billion as a result of the acceleration in the premiums issuance and the release of reserves amounting to MXN\$186 million (we expected a MXN\$325 million reserve creation).

Insured Units

Insured units advanced 5.6% to 4.4 million. This included 129 thousand new units in the current quarter. Insured units in Mexico grew 5.6%, Costa Rica 7.4%, United States 6.7% and Peru 5.8%.

Profitability

The cost of claims rose 51.7% YoY as a result of greater mobility that exceeded pre-pandemic levels, generating a 60% increase in claims handled. For this reason, the loss ratio reached 64.2% (we projected 62.5%), from 44.2% in 2Q20. This offset the 11.6% theft reduction on a cumulative basis and the improvement in the recovery rate of stolen vehicles to 52.0%. The “Adjustment Express” tool represented 22% of claims, compared to 19.3% the previous year.

On the other hand, the acquisition ratio was up slightly to 23.7% (vs. 23.2% E), from 23.2%, due to the growth of the financial institutions channel and international subsidiaries. The operating ratio decreased to 4.5% (vs. 4.5% E), from 10.2%, due to a lower profit-sharing provision. As a result, the combined ratio was 92.4% in 2Q21 (vs. 90.2% E), exceeding the previous year’s 77.6% level. This index is below the average of the last five years, but within the company’s expected range for the year.

Financial Gains

Financial gains fell 10.7% YoY to MXN\$589 million (vs. MXN\$441 million E) due to lower interest rates. The portfolio's yield was 5.9% in the quarter, in line with the guidance of 100-150 bps above Banco de México's target rate.

Net Profits

Net profits were down 56.4% YoY to MXN\$976 million (vs. the 62.1% drop to MXN\$847 million that we projected), which translated into a 29.1% ROE. This indicator was below the 46.7% of 2Q20, but was higher than the company's expectation of 20-25% long term ROE.

Solvency

The solvency margin reached MXN\$15.45 billion, which represented 625% of the minimum MXN\$2.9 billion regulatory capital requirement. This means that the company continues to have an adequate financial structure that allows it to pay ordinary and extraordinary dividends and / or expand through acquisitions.

(Figures in MXN\$ Mn)	2Q21	2Q21E	Diff.	2Q20	Change
Premiums Written	9,079	8,787	3.3%	7,107	27.7%
Net Premiums Written	9,002	8,708	3.4%	7,042	27.8%
Premiums Earned	9,188	8,358	9.9%	8,588	7.0%
Acquisition Cost	-2,133	-2,021	5.6%	-1,624	31.4%
Loss Cost	-5,899	-5,224	12.9%	-3,647	61.7%
Technical Result	1,155	1,114	3.8%	3,317	-65.2%
Net Operating Expenses	-409	-395	3.3%	-755	-45.9%
Underwriting Result	752	718	4.7%	2,565	-70.7%
Comprehensive Financing Result	589	441	33.5%	659	-10.7%
Pre-Tax Profit	1,341	1,159	15.6%	3,224	-58.4%
Tax Reserve	-365	-312	17.0%	-988	-63.1%
Net Profit Before Minorities	976	848	15.2%	2,237	-56.4%
Minority Interest	-1	-1	62.3%	-1	67.7%
Net Profit After Minorities	975	847	15.1%	2,236	-56.4%
EPS	\$ 2.36	\$ 2.07	14.1%	\$ 5.41	-56.4%
(Figures in MXN\$ Mn)	2Q21	2Q21E		2Q20	
Acquisition Index	23.7%	23.2%		23.1%	
Loss Index	64.2%	62.5%		42.5%	
Operating Index	4.5%	4.5%		10.6%	
Combined Index	92.4%	90.2%		76.2%	
Adjusted Combined Ratio	91.9%	91.4%		70.2%	
Underwriting Result	8.2%	8.6%		29.9%	
Tax Rate	27.2%	26.9%		30.6%	
ROE	29.1%	28.6%		46.7%	
ROA	7.9%	7.8%		10.8%	

Gordon Shapiro Model

(Figures in MXN\$ Mn)

Stockholder's Equity 2021E	20,117
Long-Term ROE	20.0%
Cost of Equity	10.2%
Risk-Free Rate	6.9%
Market Risk Premium	6.0%
Beta	0.542
Long-Term Growth Rate	3.5%
Equity Value	49,561
Outstanding Shares	413
Target Price / Share	\$ 120.00
Current Price / Share	\$ 92.16
Expected Dividend	\$ 3.96
Total Return	34.5%
Target P/BV	2.5x
Target P/E (Forward)	11.0x

INCOME STATEMENT (MXN\$ Mn)	2020	2021E	2022E	2023E	2024E	2025E	2026E
Premiums Written	36,057	39,784	42,907	46,224	49,697	53,450	57,504
Ceded	-381	-342	-362	-390	-419	-451	-485
Net Premiums Written	35,676	39,442	42,545	45,834	49,278	52,998	57,019
Net Increase of Unearned Premiums Reserve	615	-602	453	488	524	564	607
Premiums Earned	36,291	38,841	42,997	46,322	49,802	53,562	57,626
Acquisition Cost	-7,791	-9,300	-9,955	-10,587	-11,235	-11,924	-12,658
Loss Cost	-18,613	-24,683	-27,186	-29,195	-31,289	-33,544	-35,973
Technical Result	9,887	4,858	5,856	6,539	7,278	8,094	8,995
Net Operating Expenses	-2,507	-1,960	-2,156	-2,369	-2,597	-2,846	-3,119
Underwriting Result	7,387	2,914	3,721	4,191	4,702	5,269	5,897
Comprehensive Financing Result	1,975	2,207	2,380	2,636	2,904	3,184	3,496
Pre-Tax Profit	9,362	5,121	6,100	6,827	7,607	8,453	9,392
Tax Reserve	-2,564	-1,308	-1,572	-1,761	-1,962	-2,180	-2,423
Net Profit Before Minorities	6,798	3,813	4,529	5,066	5,645	6,273	6,970
Minority Interest	-4	-4	-6	-7	-7	-8	-9
Net Profit After Minorities	6,794	3,809	4,523	5,060	5,637	6,265	6,961
EPS	\$ 16.21	\$ 9.22	\$ 10.95	\$ 12.25	\$ 13.65	\$ 15.17	\$ 16.85
BALANCE SHEET (MXN\$ Mn)	2020	2021E	2022E	2023E	2024E	2025E	2026E
TOTAL ASSETS	69,039	77,153	82,943	88,923	95,067	101,472	110,160
Securities and Derivatives	34,893	33,482	35,482	37,482	39,482	41,482	45,482
Securities	34,893	33,482	35,482	37,482	39,482	41,482	45,482
Overnight	36	293	693	1,093	1,493	1,893	2,293
Net Loan Portfolio	339	284	284	284	284	284	284
Property (Net)	1,854	1,922	1,946	1,970	1,994	2,018	2,042
Investments Related to Labour Obligations	73	79	87	95	103	111	119
Cash and Cash Equivalents	1,692	2,115	2,555	2,995	3,435	3,875	4,315
Debtors	23,718	31,238	33,605	36,124	38,776	41,638	44,727
Re-Insurers and Re-Bonding Companies	117	149	129	109	89	69	49
Permanent Investments	47	47	47	47	47	47	47
Other Assets	6,270	7,545	8,117	8,725	9,366	10,057	10,803
TOTAL LIABILITIES	49,977	57,024	61,210	65,336	69,338	73,268	79,083
Technical Reserves	34,312	45,600	49,055	52,733	56,604	60,782	65,291
Creditors	6,339	3,487	3,623	3,435	2,897	1,927	2,454
Re-Insurers and Re-Bonding Companies	180	82	82	82	82	82	82
Other Liabilities	8,708	7,381	7,941	8,536	9,163	9,839	10,569
TOTAL CAPITAL	19,061	20,129	21,733	23,588	25,730	28,205	31,076
Minority Interest	9	13	14	15	16	18	19
Stockholder's Equity	19,052	20,117	21,719	23,573	25,714	28,187	31,057
FINANCIAL RATIOS	2020	2021E	2022E	2023E	2024E	2025E	2026E
Acquisition Index	21.8%	23.6%	23.4%	23.1%	22.8%	22.5%	22.2%
Loss Index	51.3%	63.5%	63.2%	63.0%	62.8%	62.6%	62.4%
Operating Index	7.0%	4.9%	5.0%	5.1%	5.2%	5.3%	5.4%
Combined Index	80.1%	92.1%	91.7%	91.3%	90.9%	90.4%	90.0%
Adjusted Combined Ratio	79.7%	92.5%	91.4%	91.0%	90.6%	90.2%	89.8%
Underwriting Result	20.4%	7.5%	8.7%	9.0%	9.4%	9.8%	10.2%
Return on Financial Investments (Annualized)	6.0%	6.4%	6.8%	7.0%	7.3%	7.5%	7.6%
Tax Rate	27.4%	25.5%	25.8%	25.8%	25.8%	25.8%	25.8%
ROE	41.7%	19.5%	21.6%	22.4%	22.9%	22.2%	22.4%
ROA	10.3%	5.2%	5.7%	5.9%	6.1%	6.2%	6.3%

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