1Q17 Earnings Call Transcript

April 27, 2017

10:00 AM CT

Operator: Good morning and welcome to Credito Real's first quarter 2017 Earnings Conference Call. Credito Real issued its quarterly report on Wednesday, April 26, 2017. If you did not receive a copy via email, please do not hesitate to contact us in Mexico City at +52-55-52-289753. It is important to note that the presentation and the MP3 recording referred to in this call will be available at www.creal.mx. Before we begin the call today I would like to remind you that the information discussed in today's call may include forward-looking statements on Credito Real's future financial performance and prospects which are subject to risks and uncertainties. Actual results may differ materially and the Company cautions not to rely unduly on these forward-looking statements. The Company undertakes no obligation to publicly update or revise any forward-looking statements. With us this morning from Credito Real we have Mr. Angel Romanos, CEO and Mr. Carlos Ochoa, Deputy CEO. They will discuss on the more important strategic financial and operating aspects of the first quarter 2017. I will now turn the call over to Mr. Romanos.

Angel Ramanos: Thank you operator. Good morning everyone and thanks for your available participation in our earnings call. This first quarter was off to a good start sending above the estimates of our guidance for 2017. Showing a solid resiliency of our underlying fundamentals as these are tested by the local volume and global environment of prevailed uncertainty. In this context, I am glad to tell that we were able to achieve almost Ps. 400 million of net income well above the Ps. 345 million recorded on the last quarter. Following the enhancement of our net income margin without giving up the health of our best-in-class, non-performing loans ratio which ended the first quarter at about a 2 percent mark, proof of the ongoing improvement of our operation as we move forward to integrate Instacredit into our legacy business platform while continuing strengthening the instrumental payroll credit origination. It is noteworthy that we were able to offset both higher funding costs related with the upward adjustment of the reference rates and incremental risk costs from the increase interest rate coverage of our debt, which to this date, surpasses 40 percent share of our total consolidated debt. The greater portion of our outstanding debt at a fixed rate coupled with a couple of other important initiatives will secure it to solidify our risk profile as well as the expanded maturity of our debt which was achieved towards the issuance of our senior notes to 2023 and our 100 percent coverage on foreign exchange fluctuations were reflected in the operate outlook of our credit rating of Standard & Poors this quarter going from negative to stable. Here, it is important to highlight the positive feedback received on our strategic initiatives to improve our financial position being encouraged to move forward to the right path. Additionally, we get confidence on our liquid assets as we have more than Ps. 1 million in balance in the line of cash and equivalents which is a very important asset to cope with turbulence as in this time, cash is king. Moving onto Instacredit we are very pleased with the strong growth rates recorded and with this hard data in our hands we know now that we took the right decision with the incorporation to our legacy business of Instacredit. Also thanks to Don Carro, and Instacredit we have access to 40 different markets besides Mexico affording us the opportunity to record incremental revenues in stable currencies and the contribution is clearly reflected in the origination record highs of this quarter. Moreover, we anticipate that these businesses get further momentum to achieve above one-third weight in total consolidated credit portfolio. Regarding our operation in Mexico, on the one hand we tapped into payroll credit origination including solid assets in our portfolio that belong to institutions that guarantee the service and payment of the originated loans to contributions of federal funds and on the other we continue adjusting and liquidating the originations to the prevailing environment of higher interest rates anticipating this initiative to be greater reflected in our P&L towards 2018, thus helping us to face the pressure of the net interest margins with a better position. To conclude my remarks, I would say that we are encouraged to move forward into 2017 being confident of our fundamentals, diversified portfolio and solid risk management policies. We're clearly aware of the challenging environment and 100 percent ready to walk the talk in the consolidation of our operations and to deliver attractive returns to our shareholders and stakeholders. With this I want to thank you again and leave you with Carlos Ochoa.

Carlos Ochoa: Thank you, Angel. Good morning and thank you all for taking part of Credito Real's Quarterly Conference Call. Regarding interest income during this quarter we reached interest income of Ps. 2.1 billion increasing 51 percent compared to the first quarter of 2016. This increase was mainly due to the growth in the loan portfolio supported by payroll credit origination and Instacredit which contributed 60 percent and 25 percent, respectively, of the consolidated interest income. Regarding expenses, the rest cost of funds raised to 10.1 percent as an increase of 350 basis points when compared to the 6.6 percent in the first quarter of 2016. This increase is explained by an increase in Mexican reference rent, a larger loan portfolio and full integrated consolidation. The financial margin increased 39 percent to over Ps. 1.4 billion driven by the interest income growth. Our business outside Mexico contributed to 43 percent to the consolidated financial margin. Allowances for loan losses reached Ps. 350 million during this quarter given that at the time of Instacredit consolidation we have Nexus provision according to DNDV's written methodology. During the first quarter 2016, the allowances for loan losses were unusually low. Over the next following quarters, the provisions trended towards a more stable level of around 5 percent of the total loan portfolio. In our report, we exhibited a chart that shows the proforma for 1Q16 under a 4 percent provision of (07:43) policy. Under this scenario the provision for loan losses would have been Ps. 207 million and the net income would have reached Ps. 394 million in the first quarter of 2016. Administration expenses reached Ps. 832 million during the first quarter of 2017 showing a 48 percent increase when compared to the first quarter of 2016. This growth was driven by the increase in Instacredit administration expenses of Ps. 177 million due to the full consolidation during the quarter versus one month consolidation last year. Our rise in Credito Real's expenses of Ps. 74 million mainly associated with Kondinero, an Ps. 18 million increase recorded in our two subsidiaries. In the first quarter of 2017 net income reached Ps. 396 million, a decrease of 2.4 percent year over year, just under a standard level of new health provisions achieving 4 percent of total loan portfolio in the 1Q16, the net income would have reached Ps. 294 million, showing an increase of 35 percent compared to the last year's. From cost to the key financial ratios this quarter the consolidated yield to 33.5 percent compared to the 27.9 percent in 1Q16. In this line, the net interest margin improved from 21.2 percent during the first quarter 2016, to 23.5 percent year over year. The quarter efficiency ratio increased to 50 percent mainly driven by the full consolidation of Instacredit's expenses. Since last quarter, efficiency ratio calculation excluding Resuelve since this business does not involve credit risk. ROAE stood at 7.6 percent during the quarter with raw ROAA reached 4.5 percent. Regarding our loan portfolio, it increased by 17 percent to Ps. 24.2 billion at the end of 1Q17. Instacredit and used car portfolios recorded the highest growth rate 52 percent and 35 percent, respectively. Our payroll portfolio increased by 14 percent to reach Ps. 15.1 billion supported by the pensioner's segment growth which represented 30 percent of the total payroll origination this quarter. Our durable goods loan portfolio decreased by 67 percent year over year, due to the divesting strategy in the business line. Our SME portfolio increased 10 percent year over year totaling Ps. 1.6 billion of 1Q17 portfolio. We have extended both the average loan term and amount trying to focus on larger accounts. Regarding group loans, our operators Kontigo and SomosUno reported a 35 percent loan portfolio growth. Group loan origination reached Ps. 1.1 billion in 1Q17, an increase of almost 32 percent when compared to the Ps. 877 million during the 1Q16. The Company's group loan partners continue to respond their number of customers while maintaining the strong portfolio performance metrics. Our total used car portfolio increased by 35 percent year over year reaching Ps. 2.6 billion at the end of the 1Q17. The portfolio increase was driven by expansion in our used US car business. As of 1Q17 used car business in Mexico represented only 2 percent of the total loan portfolio with US used cars represented 9 percent of the total loan portfolio. Instacredit's loan portfolio reached Ps. 4.2 billion which represented 17 percent of total loan portfolio and originated Ps. 935 million, or 20 percent, of total origination during the quarter. This quarter, the non-performing loan portfolio was 2.1 percent compared to 2.7 percent last year. The NPL improved mainly in payroll, used cars and Instacredit businesses still in line with the 2 percent to 3 percent long-term guidance as we move forward with greater loan portfolio diversification. With this I conclude my remarks and now let me turn back the call to the Operator to open the line for Q&A.

Operator: Thank you, sir. At this time the floor is open for questions. If you would like to ask a question, you may do so by pressing *1 now. We will take questions in the order they are received. If at any time you need to remove yourself from the questioning queue, or your question has been answered, press *2. Again, to ask a question, please press *1 now. Our first question comes from Ernesto Gabilondo with Bank of America.

Ernesto Gabilondo: Hi good morning, Angel and Carlos, and thanks for taking my call. Three questions from my side. The first one is in terms of your cost of risk. I believe it was kind of high this quarter. Any guidance you can give us on this will be much appreciated. For my second question is on your cost of funding, so now 40 percent of your total debt is fixed, so what is your target and how much additional costs are you expecting for hedging the rest of your debt? When should we see the cost of funding? And finally, during the quarter we saw a reduction in equity, so can you share with us the impacts behind? Thank you.

Carlos Ochoa: Hi Ernesto, thank you for your question. First, regarding the cost of risk, yes I mean if you look at all the 5.2 percent that we disclosed yesterday, it would appear to be a little bit higher than the years when compared to the 4th Quarter which was more like 4.9 percent or 5 percent. But you know something which is very important to mention is the amount of money that we collected from charge-off accounts was higher than in the previous quarters. So basically what we do, I mean just out of consistency we've been reporting the cost of risk without netting it from all of the collections that we have received from the charge-off accounts and mostly from the business in the states and Instacredit. But if you net that cost of risk out of that other income, the cost of risk would have been more like in the 4 percent or 4.1 percent range which we believe that it's a healthy standard for this business. I'm not sure if that answers your question.

Ernesto Gabilondo: Yes, thank you.

Carlos Ochoa: Now when it comes to the cost of funds what we saw during this quarter was the opportunities to fix a couple of weeks ago it wasn't (inaudible 15:07) outside so what we decided to do was to fix another proportion up to the 40 percent. We fixed the debt related to the Mexican market Ps. 1.5 billion and it was a very good way, we fixed the T, we fixed the T for 2018 debt at a level of I think it was 7.15 percent and 7.19 percent where it comes to the additional Ps. 1.5 billion associated to the senior notes due in 2023, it was fixed the T at 7.26 percent. I mean we feel comfortable right now with this figure. I mean we would like to take that figure up to probably 50 percent of the total consolidated debt but it will depend on market conditions. You know as of last week, you know prior to the last couple of days, we started listening to that there might be the chance of possibility of increasing the interest rates. I don't see that, I don't see that coming in the next year but right now I think that we take that number up to 50 percent of the total consolidated debt, that would be fine for us.

Ernesto Gabilondo: Okay, and for example, your cost of funding is around 10.1, so if you hedge it to the 50 percent of your total debt, what can you expect for the cost of funding?

Carlos Ochoa: I don't know. It's going to be probably depending on, I mean I would say … I think that in Mexico you could see that that's the year, we could expect an interest rate of another 50 basis points for this year. Probably yes, the total consolidated cost of funds by the end of the year is going to be below 11 percent, or probably in that range. It's hard to say but probably between 10.5 percent and 11 percent probably.

Ernesto Gabilondo: Okay, okay. Perfect. Fair enough. Finally on the equity, we saw a reduction in the equity. Can you share with us the impacts?

Carlos Ochoa: Yes. I mean basically what's associated, it's important to mention that we have a large of sum of money invested in our foreign subsidiaries, specifically Instacredit, that's the most visible one and also the business in the states. Mostly during the first quarter there was an unusual phenomenon in which the FX and the Mexican Peso appreciated against the dollar of around 10 percent. That has an effect over the equity for the investors in the investments made in the foreign subsidiaries as well as on the valuation of the derivative. That affected the equity during the first quarter as well as another impact of our buy-back program in which we bought close to 5 million stock in the quarter and that amounted for something around Ps. 100 million or above Ps. 100 million. The combination of these effects was explained the decrease in the equity side.

Ernesto Gabilondo: Okay, perfect. Thank you very much, Carlos.

Carlos Ochoa: Thank you.

Operator: Our next question comes from German Velasco with BBVA.

German Velasco: Hello, hi, good morning, thank you, Angel and Carlos. Just a couple of questions from my side. The first one is regarding the loan growth. We saw that this quarter it was very strong reaching 17 percent year over year, and comparing with your previous guidance between 5 percent and 10 percent, do you think it is possible that we will see higher growth rates for this year more than the 10 percent? That would be my first question. The second one is regarding the ROI. Do you expect this situation to increase in coming quarters as Instacredit is fully consolidated to the numbers of Credito Real? That would be my two questions. Thank you.

Angel Romanos: Hello German, how are you? This is Angel Romanos. First about the loan growth. We had a first quarter that was much more stable than we thought it was going to be. The end of last year was very turbulent and there was a lot of uncertainties around it. We had a first quarter that was much less volatile than we thought it was going to be. We really don't want to talk a lot about the future because it looks like a complicated year. There's elections coming in Mexico during the summer when you have the big election for next year so we do expect some volatility to develop as the year comes along. We do believe we can grow around 10 percent stable growth during the year but saying that we will grow more it's a little bit adventurous. About the ROE we do expect it to trend towards the 20 percent as the year goes by and the interest rate pass through to our consumer starts coming into the P&L of the Company.

German Velasco: Okay, very helpful. Thank you Angel.

Angel Romanos: Thank you.

Operator: Our next question comes from Tito Labarta with the Deutsche Bank.

Tito Labarta: Hi, good morning, Angel and Carlos. Thanks for the call. A couple of questions also. Following up on your margin I guess more on the yields on your loans we saw a nice increase there. I guess are you increasing rates on loans because looking at the loan mix we saw Instacredit was down a bit, so I'm not sure how much the mix helped this quarter. I just wanted to understand a bit the repricing and do you think the margin can continue to go up? In other words, have you fully absorbed the increase in your funding costs? If you can give a little bit more color on that.

Angel Romanos: Hello Tito. How are you? Effectively we started repricing all of our products on the last quarter of last year and we finished repricing them in the first 30-40 days of this year. We repriced our products even more than what interest rates have gone up in the country but you won't see the whole effect of that until the middle or 3rd Quarter of next year as everything has gone through the full portfolio. And for Instacredit, yes you have an effect that this year we have Instacredit for the full quarter and it's our product with a higher yield on it, and last year you only had it for a month and 10 days in the first quarter, so you also have that effect. We expect NIMs to remain at least the same as they were this quarter and to improve a little bit as the year goes through and we get to the middle of next year.

Tito Labarta: Great. Thanks. That's helpful. Then also following up on the question about ROE you mentioned you expect to get to 20 percent by the end of the year although if that's the case it looks like you would try to beat the guidance of net income growth of 0 percent to 5 percent. I assume that's maybe just on a quarterly basis and do you think that 20 percent is sustainable whether you reach it by year end or next year, is that where we should be in a more normalized environment?

Angel Romanos: It should trend to 20 percent and that's where we want it on a normalized environment going forward.

Tito Labarta: Okay, but for the full year you probably won't be able to get that, right?

Angel Romanos: No, the average will be below that because we're starting at 17.something percent.

Tito Labarta: Okay. Perfect. Thank you.

Operator: Our next question comes from Alessandro Orlant with Bank of America.

Alessandro Arlant: Good morning gentlemen, thank you for the call. I arrived at the call a little bit late. I was just wondering if you could give us an update on the 2019 bond if you intend to call the bond next month?

Carlos Ochoa: We haven't decided yet what we are going to do with that one because now the positive thing about the remaining 2019 is that the interest rate that we are paying for that one is below 7 percent 16 pesos. From the beginning of the year we have been very emphatic about the fact that profitability and especially cost of funds is going to be a major issue for the Company this year. In that sense the 2019 are one of the cheapest sources of bonds at this time. Most likely we are not going to call that bond but we haven't decided yet.

Alessandro Arlant: Okay, that's fair enough. Thank you so much Carlos. Then my other question would be just more in general terms. We've seen that the growth of the portfolio has slowed down if you look at quarter on quarter and origination even at the payroll lending level in Mexico has also slowed down. Could you give us an idea of what's going on, on the ground particularly in Mexico in terms of the expectations of the slowdown on the economy if we are already seeing the bulk of the slowdown or if you do see that there is more downside risk especially with what's going to happen with policies in the US and what could happen with some of the elections you will have during the summer. Just short-term, six-month outlook would be great especially looking at your asset quality which still continues to be quite good and still has been quite responsive, right, to the efforts that you've made. But I think in the short-term you still have a lot of volatility.

Angel Romanos: Alessandro, hello, this is Angel. We've been growing a lot in Mexico. If you look at the data we sent on the sheet that our payroll business has grown 14.4 percent of the portfolio. Origination wise we're close to 20 percent quarter versus quarter, 2017 to 2016, so we do believe that our growth in Mexico is very attractive and we can remain growing at that pace on the payroll business for the rest of the year.

Alessandro Arlant: Okay, so you're not, I mean as it is right now it will be steady. You don't expect any significant slowdown from here?

Angel Romanos: No, we haven't seen any slowdown on our payroll business whatsoever. We don't expect it to happen.

Alessandro Orlant: Okay, that's good. Thank you so much Angel.

Angel Romanos: Thank you Alessandro.

Operator: As a final reminder, whoops, sorry, as a final reminder press *1 at any time for questions. Our next question comes from Rodolfo Ramos with Franklin Templeton.

Rodolfo Ramos: Hi Carlos and Angel. Just a quick question on your payroll business and a follow-up on the repricing. Can you explain to us how does that process going specifically as it relates to payroll and have you done any of them so far? Thanks.

Angel Romanos: Yes, we have been repricing most of the contracts we have with our distributors have with the government entities. They are renegotiated every year or every three years. So all the contracts that were negotiated, were negotiated by the end of the year, we made a pass through of our only costs to the end consumer. We have no problem with that and the ones that weren't due for negotiation this year we also approached the government agencies through our distributors and negotiated a pass through of funding costs and so far we haven't had any trouble with any of the contracts we have.

Rodolfo Ramos: Thank you. Just a quick follow-up. Can you say how much of your loan book on the payroll side has contributed profits?

Angel Romanos: I would say that about between 80 percent and 83 percent of our originations have already been made with the new interest rates.

Rodolfo Ramos: Perfect. That's very helpful. Thank you, Angel.

Angel Romanos: You're welcome.

Operator: Our next question comes Natalia Corfield with JP Morgan.

Natalia Corfield: Hey, hi Carlos and Angel. My question is with regards to the facts. I was actually impressed by the FX has in your balance sheet. First of all, just to clarify the equity side, the decline in equity was related to the investments that you have outside Mexico, so it's Instacredit? If you could confirm that it would be great. The second thing also is with regards to your derivative securities because it had a big decline in the quarter so if you could explain how exactly this works it would be very useful for me. Thank you.

Carlos Ochoa: Hi Natalia. Yes, you know in broker terms what I can tell you is that Credito Real has investments in foreign subsidiaries of about Ps. 3.5 billion or something in that range. Clearly a decrease in the FX of 10 percent as we saw during this quarter has a negative effort over the equity in that sense. Additionally, if you look at all the debt US dollar denominated debt is hedging at some level, it's hedged with a full cross-currency swap. The value of these derivative results have a negative effect which affects clearly the equity. Finally, the last one was with the buy-back program. As I mentioned we bought about 110 million worth of equity during the quarter. The combination of all these effects, affected the equity. However, for the next quarter we are seeing with the FX, probably we are going to see the contrary effect to that one. We could provide you some further details by email to you directly.

Natalia Corfield: Sounds good. But the decline that we see in your position of derivatives in the balance sheet is that only related to FX or is that also related to FX and rates?

Carlos Ochoa: No, it's only related to FX.

Natalia Corfield: Alright. Thank you very much.

Carlos Ochoa: No problem.

Operator: With no further questions in the queue, we will now conclude the question and answer session. Thank you all for being in today's conference call. You may now disconnect your lines.

Carlos Ochoa: Thank you all.

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