1Q21 Earnings Call Transcript

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Operator: Good morning and welcome everyone to Crédito Real's first quarter 2021 earnings conference call. Crédito Real issued its quarterly report on Wednesday April 28, 2021. If you did not receive a copy via email, please do not hesitate to contact us in Mexico City at +525552289753. It is important to note that the presentation and mp3 recordings referred to 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 Crédito 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 statement. With us this morning from Crédito Real we have Mr. Ángel Romanos, Executive Chairman, Mr. Carlos Ochoa, CEO, and Ms. Renata González, IRO. They will discuss on the more important strategic, financial and operating aspects of the first quarter 2021. I will now turn to call over to Mr. Romanos.

Ángel Romanos: Thank you, operator. Good morning, everyone. This is a very special call for me as it marks a very important and positive step forward in Crédito Real's decades-long and succesful journey. So I would like to begin by thanking you all for the very warm and constructive relationships that we have been able to build over time. Thank you for the trust you placed in us and in me personally. The steps that we are taking as an organization are intended to deepen that trust. Here is a couple that I want to highlight. In line with international best practices in terms of corporate governance, we have divided the role of Chairman and CEO, apointing different individuals in each. As Chairman of the Board I can speak for the entire group when I say we are very proud to have appointed Carlos Ochoa, who you all know very well, as the new CEO of the Company. There is surely no better individual to lead the Company's executive team and we are all looking forward to the many successes I am sure he will bring about in this Company. Also in line with strengthening governance at Crédito Real, the Board of Directors will be taking a more proactive role in defining key strategic items, strengths, oversight and accountability while living additional room for the executive team to focus on achieving the ambitious goals we have set in terms of improving our portfolio and deepening our differentiation. Carlos will speak more about this in a few minutes. I will leave all the details to Carlos and Renata, but before I do that, I want to thank you again for your unwavering trust. I remain as inspired by our purpose as I was in day one. We will continue working to support the dreams of unattended people and small companies in the Americas as we have done over 25 years. Reaching at this report that transcendental milestone of one million customers and I look forward to continuing to discuss our progress over time with you all. Please do stay in touch Carlos quite literally, I hand it over to you now.

Carlos Ochoa: Thank you Angel for your kind words. Good morning everyone and many thanks for being with us today. I can only second what Angel has said with regards to how extremely valuable we call the relationship that this Company has built with analysts and investors over the years. We definitely consider this relationship as a substantial asset of Crédito Real. It is also a very special call for me. I am particularly humbled, to be here as the new CEO of Credito Real, I am proud to have spent almost 3 decades learning from industry leaders like Angel and the incredible team he has built here. Despite the overall macrochallenges, I am confident that the strong foundations built under Angel’s tenure as CEO set us on a solid track to successfully serve the unattended segments of banking, and over this activity, create sustainable value for our stakeholders. His continued leadership as Chairman of the Board will remain invaluable for the Company. Going into my assessment of the reporting period. The first quarter 2021 marks the one-year anniversary of COVID-19 in the Americas. We are proud of our response and the value that we have been able to deliver to the communities we serve. Since its onset, we have prioritized the health of our associates and clients, provided an outstanding support for SMEs to navigate through the difficult environment, we have deployed an effective use of the technology while accelerating our digital transformation. Amid the new normal I would like to begin by emphasizing that the Company has adopted a renewed focus on strengthening corporate governance, transparency and accountability. We have made great strides to strengthen our corporate governance framework in line with international best practices. A clear example of this is separating the Chairman's and CEO's role, specifically in terms of executive (inaudible), independence of the audit committee and corporate governance. The increased independence of the Board's committees under additional capabilities in terms of oversight also stand out. The team will strengthen in the coming months, in this regard we have started the search for a new CFO. In parallel to implementing best corporate governance frameworks focusing on a strong and robust processes, our strategy of prioritizing value over volume in our portfolio is gaining more traction. This is not just the right risk mitigation strategy in the current context, it will (inaudible) our differentiated value proposition to investors over the long term. This is paired with improvements in collection, that includes a wider adoption of data analytics and monitoring systems, under a proactive framework of customer relations, outstanding in Central America the launching of a payment-point network through several strategic partnerships with major commercial chains that is already bearing results in the segment’s delinquency. Before moving on. I would like to take a moment here to clarify recent events. During the ordinary course of our annual financial review process for 2021, our auditors requested, applying the strictest accounting criteria, that only one credit within the SMEs portfolio would be incorporated in the past-due loan portfolio. It is important to note that the specific characteristics of this credit were previously communicated by the Company to the market. Further this request in no way implies or results in the restatements of audited financial results from previous years. As I explained, it was the result of the ordinary review process from preliminary 4Q numbers to audited financials. Of a total of more than 650 accounts that we have among small and medium businesses, that one loan in particular explains the increase in the NPL rates, the cost of risk and the coverage ratio. In addition, the rest of our portfolio in the specific segments where we operate maintain NPL percentages far below our counterparts in the market. It is also important to note that as part of the same financial review process, our auditors also identified that the Company was being overly rigorous in the matter of which we amortize assets related to the leasing activity. Previously, these assets were amortized over the term of the lease. However, following the suggestion of our independent auditors, these assets will be amortized over the duration of their service life. This modification created a positive effect on the amortization rubric and an increase in the fixed assets. This explains the fact that the Company's profitability levels have been maintained without significant changes, following the revision of the account in question. All in all, with regard to the ships in our NPL rates are caused by the single outlier loan I have explained, it is important to consider that it currently stands at 3.9% expecting to see it in a range around the 3% over the second half of the year. Besides considering the explanation I just provided, I will just take a moment to analyze this method at the light of delinquency reported by our peers and banking. Peers' delinquency, as you might be aware, has already broken the glass ceiling of double digit NPL rates in different products of credit consumption, such as credit cards. Therefore, we acknowledge the good work delivered by our endeavors to contain the delinquency in the rest of our portfolio. Similarly, it is relevant to underscore that although the NPL ratio posted a 2 percentage points increase, the loan that caused it it is backed by colateral, same that we are already striving to execute, as we announced in our recent communications. We are targeting to achieve a higher cash and lower delinquency once these guarantees are monetized, pushing the

NPL ratio significantly down given the good health of the rest of our portfolio. When including these factory in the analysis the NPL ratio lies around 2.5%. Turning to our performance by business segment. Although COVID-19 has surged in the countries where we operate, those trends have started to weaken, as vaccination, particularly, in the United States, has started to pick up, thus creating certain stability in our overall operating environment. In this regard, it is worth noting that the measures adopted in the past quarters to prevent deterioration of the loan portfolio will remain in place until seeing stronger signs of recovery in the sectors we attend, even at the face of the start of better demand dynamics. In this context, Payroll origination improved on a sequential basis, with a delinquency level below 2%, a rate considerably lower than the sector's average and comparable to banking. This performance was achieved at the back of the solid fundamentals of this legacy business and the increasing contribution of our commercial agreement with Famsa, which we expect to ramp up over the year, as we are being able to tap into its extended footprint in North Mexico. Used Cars origination continued showing sound fundamentals, as demand picks up before COVID-19 contagion risks of public transportation. Separately, Used Cars Mexico collection remained sound, benefiting from the surging demand that allow us to select solid credit profiles, closing the quarter with an NPL rate of 2.5%. Meanwhile, Used Cars origination in the United States has already reached pre-pandemic levels, with a best-in-class non-performing loan ratio below than 1%. Small- and Medium-sized Enterprise origination in Mexico slowed down on a sequential basis, following our prudent approach of temporarily freezing credits, but relief programs are clearly stabilizing, as these represent only 3% of total portfolio. In contrast, SMEs USA remained advancing at good pace, despite the effects of the winter storm in Texas, highlighting the growth trend attained in collection, coupled with stable delinquency. Turning to Instacredit, the combined effect of a widen outreach and higher efficiencies allowed us to capitalize on the recovery of Costa Rica, Panama and Nicaragua, as we have been able to benefit from the conservative approach of commercial banks, which are underserving clients that it used to attract and retain, allowing us to add better credit profiles than our average client. These dynamics are clearly reflected in the improvement of Instacredit's profitability and delinquency of last reporting periods and moved forward this quarter. On the financial front, we have already refinanced about 30% of 2021 year maturities and count on a solid cash position, while firmly advanced towards the securitization of the loans' portfolio of our operations in the United States. This facility is expected to reach 130 million dollars. I am also happy to report that we closed as recently as April 22nd, a refinancing with BNP Paribas for 50 million-dollar, this loan is secured and even more competitive interest rates than the original for 10% for one year. This refinancing is a concrete signal of unequivocal confidence in our business model and substantial results. We are also getting positive fresh feedback from key stakeholders such as credit rating agencies and regulators with which we get healthy and transparent relationships. It is worth noting that proceeds pending of use from Senior notes due 2028 are generating a negative carry, this effect that will be gradually decreasing and fully ended with the deployment of a high-quality origination in the quarters to come. Wrapping up, the operating and financial stability consolidated in 2020 to face the pandemic, coupled with better macroeconomic prospects and a further progress on COVID-19 vaccination, make us feel confident to preserve our asset quality in the short-run; and capitalize on the surging demand in the medium term. In this sense, we clearly understand that the strength of our balance will be a paramount to succeed, as we expect that best grounded players of our segment, as it is Credito Real, will take a stronger market position both from banking and other participants. Likewise, we are quite glad to see the traction of our commercial agreement with Famsa, which is already delivering a higher contribution than Credifiel, backed on the solid fundamentals of North Mexico, which region that has outstood as the most resilient in the country amid COVID-19, giving its manufacturing orientation that is tightly integrated to the US economy. To conclude, we are pleased to accomplish the one-million clients mark this quarter, while continue striving to weather the environment and strengthening our governance and key corporate practices, to evolve from a defensive posture to a growth mode towards year-end. Rest assured that we are to arise stronger from the COVID-19 challenge. With this I conclude my remarks and I hand the call over to Renata, please go ahead.

Renata González: Thank you, Carlos and good morning everyone. Starting with the P&L analysis, interest income for the first quarter 2021 increased 4% year-over-year, to 2.8 billion pesos, mostly reflecting a certain degree the recovery of economic activity and the incremental contribution generated by the adquisition of the loan portfolio of Banco Famsa as well as a foreign exchange gain experienced during the quarter. In this context, total income was up 14%, to 3.2 billion pesos, benefited by both the annual growth in interest income and a higher amount recorded in other operating income. Interest expense amounted to 1.5 billion pesos, increasing 39% year-over-year, propelled by a higher indebtedness. The financial margin stood at 1.3 billion pesos, decreasing 19% when compared to that of the first quarter 2020, as a result of a combined effect of higher interest expenses and a negative carry. Net provision for loan losses totaled 490 million pesos, increasing 6.5% year-over-year, primarily reflecting the additional allowances built to face COVID-19 during 2020. Although the coverage ratio decreased to 117%, from 219% in 1Q20 due to a larger past-due balance that offset the creation of provisions, we deem this level suitable to cover potential losses. In contrast, cost of risk increased 10 basis points, to 3.8%. Administrative and promotion expenses were up 16% on an annual basis, amounting to 895 million pesos. Net income totaled 89 million pesos, compared to 306 million in 1Q20, following the effect of the negative carry and a non-recurring loss in intermediation income related to a derivative unwinding by the prepayment of a dollar-denominated credit line. Excluding non-recurring effects, net income should be a 125 million pesos. Return on Average Equity was 2.1% as of quarter-end. And, when excluding the Perpetual Notes, it attained 2.9%. Return on Average Assets stood at 0.5%. Capitalization dropped 7.0 percentage points, from 38.4% in 1Q20 to 31.4%

as of quarter-end. Average cost of funds was 11.2%, compared to 9.4% registered in the same period last year, mostly due to the negative carry and to a lesser extent, to certain refinancing credits of high spreads. Excluding the negative carry, the cost of funds was 10.4%. Here, it is worth noting that worldwide the low interest rates cycle maybe be come to an end this year at the light of inflationary concerns. In this sense, we will remain monitoring the monetary policy of relevant central banks to quickly recalibrate our funding strategy. Breaking down credit portfolios. The total portfolio expanded 9.8%, to 54.7 billion pesos, at the end of the quarter, primarily driven by the growth achieved at Payroll and SMEs. Our consolidated non-performing loan ratio was up to 3.9% this quarter, following the recording of a specific non-performing loan in SMEs, whose subjacent collaterals are undergoing due execution and monetization processes. On Payroll, the loan portfolio totaled almost 32 billion pesos, increasing 12%, supported by our commercial agreement with Famsa and by the adquisition of the portfolio of Banco Famsa. Non-performing loan ratio of this segment remained stable at 1.7%. SMEs posted an annual growth rate of 18.8%, to reach 12.5 billion pesos. As was the case of the previous quarter, the growth rate of the segment declined when compared to pre-pandemic levels following a softer business activity at all markets we serve, coupled with the implementation of selective origination standards aimed at downsizing our exposure to at-risk sectors. The non-performing ratio of this segment increased to 12.0%, following the specific delinquency of a single loan that has been already discussed, having and overall stability on the other assets of the portfolio. Non-performing loan of this segment is expected to gradually stabilize over the coming periods. In the same approach of asset quality preservation Used Cars' portfolio posted a slight growth of almost 1% on an annual basis, amounting to 4.1 billion pesos, while posted a 30 basis points annual contraction in its non-performing loan ratio, which stood at 1.5%. Instacredit's loan portfolio amounted to 5.2 billion pesos, down 14% on an annual basis, but delivering an incremental profitability. It is important to note that SMEs Mexico's portfolio weight in the total loan portfolio is expected to decrease, in line with our action plan oriented to most profitable segments. Moving to the balance sheet. As of the end of first quarter 2021, total assets amounted to 77.2 billion pesos, 6% higher than that recorded last year, in line with the growth recorded at the consolidated portfolio and the comprehensive execution of funding and hedging initiatives over the last twelve months. Total debt increased 12% year-over-year, to 56.9 billion pesos, following the placement of Senior Notes due 2028 and other financing activities conducted over the last twelve months, including the subscription of the DFC credit facility. Finally, stockholders' equity reached 17 billion pesos, decreasing 10% year-over-year. With this, I conclude my remarks. Now let me turn back the call to the Operator to open the line for Q&A.

Operator: Ladies and gentlemen, I apologize for the technical difficulties, but we will go ahead with the Q&A session. In order to ask a question, please press *1 on your telephone. At at this time. If you are using a speakerphone, please make sure that your mute function is turned off to allow your signal to reach our equipment. Your first question comes from the line of Ernesto Gabilondo with Bank of America. Please proceed with your question.

Ernesto Gabilondo: Good morning Angel, Carlos and Renata. Thanks for your presentation and Carlos congrats on your new position. As you know, after the restatement of your financial statement, there have been a lot of questions coming from investors. So let me make you some of those questions. The first one is the timing. Why after Alpha Credit's restatement? and why now? as in the past, you have not done so much adjustments. Today there were some adjustments in the balance sheet, mainly related to asset quality, there was no impact in the net earnings but with a lot of moving parts, so I want to understand this. And then my second question is on the deterioration of the specific SME client. We are receiving concerns on how diversified is this portfolio and how is the size of your top ten clients in this portfolio? Because it was very surprising that only one client doubled the NPL ratio from 1.8 to 3.3%. Thank you.

Carlos Ochoa: Hi Ernesto and first, I am sorry for this inconvenience with the technical issue it is completely unrelated to us. But let me address your question, your first question. It is completely unrelated, It is completely unrelated because on the first hand we did not restate any of the, we did not restate financials. The change was, you know, 4Q figures were preliminary figures and basically, that is what happened. I mean, the full financial statements were due in that day and basically, that is what happened. I mean, we were working with preliminary the 4Q figures were preliminary financial statements and let me be very clear about this, there was no restatement whatsoever I mean. And the thing that happened just after Alpha Credit was nothing related to us, it was basically because that day on friday, we held the shareholders meeting over here in Mexico and basically the financial were released that night and basically, that is the thing about it. I mean, and coming to your second question of the this particular client that we have been disclosing from the beginning of the year. I mean, what is very important to point out is that what makes unusual these customers is that it did not pay, right? I mean over the ordinary course of business we have customers, all sorts of customers with different characteristics and so on. And basically this is the only the thing that makes this particular loan outliers is because it did not pay. What we have been doing lately and those are part of the changes that we are having here at the Company is to strengthen our processes and board the risk analysis and risk management as well. And that is basically where we are standing, you know, in order of not having these type of problems in the future, strengthening of the, you know, the credit committees, both internal and the Board of Directors' credit committee as well, so basically that is where we are standing. But we have been very, since the onset of this situation, we have been very transparent about this particular customer and that is what we intend to... what we intend to do in the future is to focus on having the right processes, to strengthen them and bad decisions, bad business decisions are a part of our business. So basically that is what I can tell you about this particular loan.

Ernesto Gabilondo: Thank you Carlos, and then let me make you another question that I got related to other receivables. We have been seeing that it increased from around five million pesos to nine billion pesos in the last year and a half, and I believe this is because you provide on front some cash to your table on distributors to originate the loans. And I think that you agreed with the Social Security institution the IMSS to provide a grace period for your clients due to the pandemic and that you will receive that money after the maturity of the payroll loans and then we will be able to reduce the other receivable account. So, please let me know if this is really what is happening in the increase of further receivables and where do you have the bulk of federal loans maturing in order to see when should we see the receivable accounts being collected.

Carlos Ochoa: Well, I mean if you think that the largest portion of that, of the other accounts receivable is completely associated, is completely associated to the duration of the book, of the payroll book. So in that sense, what would happen if today for example we stop origination altogether that particular account, the income paid in advance to distributors, would you know, naturally unwind, right? So this is the largest portion of it, even though there was a jump associated, you know, with the explanation that you gave, you know, that is related to the IMSS and so on and so forth, this particular item is associated to the duration of the loan, that is very important to mention. If you look at the different lines specifically in the, in the other accounts receivable, there was a jump in the receivables from subsidiaries and this jump that you get to see over there was due to the consolidation of CRA, which was not performed at the beginning, at the end of 1Q20 and it was done in the second quarter. So if you look at that spike, which amounts roughly a billion pesos in there, what you have are, you know, a number of different things. For example, you have a trust, you have VAT that is supposed to be collected, you know associated to the leasing activities and so on. But if you look, you know, other than this effect, that is mostly explained by the consolidation of Crédito Real Arrendamiento, the other lines have rather performed, the other lines have stayed perform associated with the nature of the business, you know, in particular the payroll business.

Ernesto Gabilondo: Perfect, thank you very much, Carlos.

Carlos Ochoa: Thank you Ernesto.

Operator: Your next question comes from the line of Carlos Alcaraz with Apalache Analisis. Please proceed with your question.

Carlos Alcaraz: Hi everyone, thank you for the call, I have two questions. The first one is in used cars, we can see a higher NPL of 1.5 from 0.9% during the last quarter of the 2020. Which was the cause of this increase? And the second one is, where do you see this NPL in the future? Thank you.

Carlos Ochoa: I am sorry I missed in what line you said, excuse me? The NPL ratio of what you were saying?.

Carlos Alcaraz: The NPL of 1.5 from 0.9 during the last quarter of 2020, which was the cause of this increase?.

Renata González: Yes, the increase on the consolidated loan portfolio was mainly on the SMEs line, which in particular is related to one single customer, which we already communicate, which was included on the 2020 financial statements as a non performing loan, and right now we are still having that clientt on the nonperforming loans ratio. That is why you could see an increase on the SMEs line which also brought off the consolidated loan portfolio.

Carlos Alcaraz: Okay, where do you see this NPL in the future?

Carlos Ochoa: I mean if you isolate the effect of this particular customer, it could be something in the range of the 2.5%-2.6%, I mean that is very important to stress. So basically what we are doing right now, we are focusing, the focus for this year clearly it is going to be over asset performance. So basically what I am saying is that if I have to answer you this, you know from an operational perspective, is that all the efforts will be focused over there, and we have the adequate tools to track and solve this and solve the situation that we are currently facing. But that is going to depend on the, you know, on the length of the judiciary process and things like that. But anyway, by the end of the year, I would expect the NPLs to be something around the 3%, as I already mentioned in the... given my opening statement.

Carlos Alcaraz: Okay, thank you.

Operator: Your next question comes from the line of Nicolas Riva with Bank of America. Please proceed with your question.

Nicolas Riva: Thanks for the chance to ask questions and congrats again Carlos on the new responsibilities. I have three questions, the first one following up on what Ernesto asked before about the changes to the fourth quarter figures. So one thing I noticed is the NPLs increased by roughly 700 million pesos, right? But the non-loan reserves in the balance sheet barely moved, so that tells me or that suggests that you did not book much additional provisions for these SME client, and my question, well first of all, is that the correct assessment and second, how much have you provisioned for this loan which is about 35 million dollars? That is my first question.

Carlos Ochoa: Let me address that one... if you want me to address that one... So, what I can tell you is that the increase in the provision made at the end of the 4Q amounted roughly 185 million pesos. That was the change that was increased in the provision for that particular loam. If you look at the, you know, expected losses, you know, provisioning, the likelihood of default of that particular, of that particular loan stood at 15%. When that was moved and was recorded as an NPL, that likelihood of default increased from the 15% to the 45% and this is basically the increase that I am saying those 185 million pesos. So basically out of that, you know, out of the 595 million pesos of that particular loan are roughly 388 or 400 million that are already provisioned. The changes that you get to see, the effect that this have over the coverage ratio is very visible. If you look at the coverage ratio, it went down basically 100 points and this is because of the increase in the NPL. This is because of the increase of the NPL. So it is very important to mention that expected losses are different than NPLs and basically the expected loss for that particular loan stands at 45% and the, whereas on the NPL side, is accounted as 100%. I do not know if that answers your question.

Nicolas Riva: Yeah it does, okay. So you have you have covered 45% of this particular SMEs loan and so you could have to book additional provision because there is 40%, there are 55% which has not been provisioned for but I would assume that, I mean, you said in the earnings report, you have some guarantees and collateral on this loan. And then the differential is what you have to collect.

Carlos Ochoa: Correct, so in that regard the maximum exposure that you, that we will hold at the time would be the difference, probably another 50%. The more we collect, the better the percentage is going to be.

Nicolas Riva: Carlos, is there any color you can provide us in terms of whats that collateral and the timing in terms of collecting on that collateral?

Carlos Ochoa: Sorry, we cannot provide so much information about that one. What I can tell you is that there were collaterals and that we are, and that particular loan is under litigation at this point.

Nicolas Riva: Okay, understood. My second question Carlos, on... I wanted to ask you something related to Alpha Credit and it is, would you be interested in acquiring some of the payroll loans or control agreements held by Alpha? And also something that is related to this. In January, you acquired these portfolio payroll loans from Banco Famsa. Can you tell us the percentage that you paid of that loan portfolio? In other words, what was the haircut to that long portfolio, was it 50%? was it 40% roughly? I am gonna call us...

Carlos Ochoa: Look, I cannot provide much color on the second part of your question. I am not able to disclose that part. Whatever, what I can tell you is that that was one of the important drivers for the increase in the income, under the income line came from that particular, you know, from that particular portfolio. So basically what I am trying to say is that that was definitely a good deal. When you asked me about Alpha, I am not getting too much into that. I mean we are always looking for opportunities for different portfolios, such as what we did with Famsa and it would be interesting for us, you know, to see whether there is something interesting for us... whether there is something that we could buy out. In that sense, what I can be very emphatic is that we do not buy contracts, Crédito Real has no contract with any government agency whatsoever. And this is because we have a different business models than theirs, I mean our different... whereas they have a vertical, you know, an integrated platform, we rely on distributors and that makes a big, big difference and probably the most visible and important one at this point is that we have no contracts whatsoever and we have different assets you know, we have different assets as well.

Nicolas Riva: Understood Carlos. My last question, looking at the covenants in some of your bank debt. Those include a 4% NPL ratio and a 3.5 times debt to equity. Right now you are very close to those metrics, 3.9% NPL ratio, there is another 2% on the relief. And then you are 3.3 times debt to equity. Has this issue been raised by any of your lenders or what are your thoughts about this topic?

Carlos Ochoa: Look, I mean for starters we are very conscious, we are very conscious about the situation but we have tools to solve this. And and basically let me start, you know, one of the advantages that we have at this point is the breakdown of our group. So what I am trying to say is that as long as we continue to outweigh this particular fraction of our portfolio, speaking about the SMEs portfolio, I mean, we could dilute the effect over the NPLs right? We could dilute a little bit the effect over the NPLs. Finally, I mean, what I mentioned already to, what I mentioned already before, is that even though from the operational perspective we are focusing all our collections efforts are focused on, you know, on these particular credit and other lines of credit... and other lines of collections. What is important to stress at this point is that the intention that the company has for this year is that we should not increase the leverage at all for this year. We are going to rely on our own resources and probably in that same sense, what is very important to address is that if you look at the amount that we called in cash or cash and equivalents right now, roughly 250 million. I mean, we are in a very, a very good position. So what I am saying is that we could grow the book, if you think in terms of liquidity we could grow the book by something around the 7%-8%, still growing the book 7% to 8% without getting new money, without getting new money whatsoever. And finally, the, basically what I am trying to say in short, as a summary is that we have no liquidity issues. We have no risks of refinancing, I mean and a good example of this is what we performed last week, as recent as last week with BNP Paribas.

And we believe that the experiences that brought to us last year, you know, refinancing without accessing the market, put us on a very good positions and finally if words come to that, we could write that particular loan-off and lower the NPL ratio, you know, to the 2.5% range or something like that. I understand that this will have, this would have a negative effect on the P&L but we, what we are aiming right now is to preserve the financial stability and solidness of our balance sheet.

Nicolas Riva: Thanks Carlos, one last question, if I may. On collections, you mentioned the collections on the entire loan book of 7.8 billion pesos this quarter. Can you tell us what were the collections specifically in the payroll portfolio? Because I saw the payroll portfolio increased by 2.3 billion pesos and that was exactly the amount of originations in the loan books. So I was wondering how much did you collect actually on the payroll loan book?

Renata González: Hi Nicolas, actually, the collection from payroll remained rather stable. They were in line with the collections we had throughout 2020. The decreased we experience on the collection during the quarter came specifically from the SMEs segment. I think it is also important to to mention that given that for example, there are... on the factoring side right now we are very limited and not originating this kind of short-term revolving loans that we used to run, used to help on the collection rates and right now we are not having that effect.

Nicolas Riva: Okay, thanks very much, Renata and Carlos.

Carlos Ochoa: Thank you Nicolas.

Operator: Your next question comes from the line of John Hough with Mizuho. Please proceed with your question.

John Hough: Hey, good morning, everyone, well good afternoon depends if you are over here, good afternoon. Congratulations again, Carlos on the the new role and sorry to see Angel go and hello Renata. Carlos, in the beginning of the call, in your intro, you said you expect NPLs to be around what, in the second half of the year? Just to confirm that number.

Carlos Ochoa: Yeah, something around 3%.

John Hough: Okay. And you know, with the relief programs rolling off, you know, do we, do we expect any, what could be any sort of expectation of the NPLs into the second quarter? Into maybe the third quarter?

Carlos Ochoa: Yeah, I would say it is going to remain rather stable. I think we are making some progress. I mean, I am not going to get into this, you know, outlier that we have been speaking throughout the call, you know, in particular, because we are, you know, as I mentioned, there is a judiciary process in place and that might be lengthy. However, the progress is that we are seeing in the other lines that are already non-performing and I feel confident about that. So even though it could be rather stable, probably we are going to be on the, I do not know, probably is going to be on the range of the 3.5% or something like that. If you look at our presentation, if you look at the, the earnings release, there is a clear improvement in the different lines. There is an improvement in the uses cars, there is an improvement in Central America and there is an improvement in the other lines of business. The only one that is missing is on the SMEs and that is exactly where we are focusing all our efforts. So I would say that if we manage to accomplish it there is going to be an improvement in the second, not a major improvement in the 2Q but there is going to be an improvement.

John Hough: Yeah. In terms of that loan that you discussed. Did you actually disclosed the actual amount, you know, is it 700 million pesos or 750 million pesos. Is it in there?

Carlos Ochoa: Yes. We disclosed it at the beginning of the year, I mean, we were in the middle of the, you know of issuing the 2028 and we disclosed that particular loan. I mean probably what is important to highlight at this point is that we do not have a systemic issue. We do not have a systemic condition. We are speaking of isolated cases and we are addressing it and we are addressing them consistently. So basically that would be kind of the methods that I am trying to convey here to you.

John Hough: Yeah. What... do you have a number if you took out that one item, what would your NPLs be without that loan?

Carlos Ochoa: Sorry John, I did not get it.

John Hough: If you took out that one loan that increased your NPLs, what would your NPLs be this quarter is it? I mean, I know it is not the big jump that we see, but it would be slightly higher and I am just wondering what that number would be.

Carlos Ochoa: Yeah, 2.5%. And probably the best way to isolate this effect is if you think in terms of the, if you think in terms of the 4Q figures that, the beforementioned 4Q figures, it went up from the 1.8% to the 3.3% for this particular item. So basically if we remove it with the 1Q figures it would be something around the 2.5%.

John Hough: Okay, my other question is about this, with the foreclosed assets line item. You know, at what point does this loan move down to the foreclosed assets or does it, you know, not.

Carlos Ochoa: Well, I did not understand very well but let me let me speak you about that particular line of the foreclosed assets. What we did at the end of the year in order, I mean, normally let me, let me, let me put it this way. I mean the focus for our collection efforts has always been the cash. However, when we pay situations such as the ones we faced last year in some particular cases in which we believe that getting the cash is not going to be as manageable, we try to reach and we negotiate with customers in order to solve the situation and that is basically what we did. We repossessed some assets, we foreclosed some assets in the amount of that. So the most important part, I mean, the effect that these foreclosed assets have, If there is a change in the you know, if you look at the asset side of the balance sheet, there is a change, you remove it from the portfolio line and you move it into the foreclosed assets. In order to do that, you have to have, you know the right appraisals, you have to have, you know, you have to test them for impairment on a regular basis and more importantly you have to be able to monetize them fast. So as similar as you know on a different priority is to monetize all those assets and I definitely believe that we are going to see an improvement in that particular line during the 2Q. So basically to put it in short, we tried to collect and maximizing collection as of the 2Q and that is what we are what we are aiming.

John Hough: Yeah. All right, thank you. And one last one follow up is, you know, per one of the gentlemen before me asking. We brought up the SMEs portfolio and you have this one loan that was an issue. Is there any other loans that you have identified that are potentially issues or you know, that could be an issue in coming quarters? Not that we will have a surprise but you know, that you are starting to run into that issue.

Carlos Ochoa: I mean, as I mentioned before when I was answering Ernesto, what makes this, the extraordinary feature, the extraordinary nature of this particular credit was the default, nothing else. So basically the focus and the measures that we have taken are in the sense of strengthening in all our credit analysis, the risk management and so on and so forth in order of not having these outliers. But that is where we are standing. But what is very important and the measures to convey is that the default was the extraordinary feature about this particular credit.

John Hough: And you mentioned your funding, your funding is fine and you do not need to originate. But can you talk about any potential refinancings you need to do for the rest of the year for the rest of the 2021?

Carlos Ochoa: No, we, I mean we believe, I mean based on our experience on last year's experience, we believe that we will be able to roll, you know, all the, all amortizations over and right now we are focusing on refinancing the CHF as of February 2022, that is basically what we are aiming. As I mentioned, you know, the liquidity of the company is solid enough to being able to grow 7%-8% without getting new money. So basically that is where we are standing, you know.

John Hough: Thank you Carlos.

Carlos Ochoa: Thank you John, thank you very much.

Operator: Your next question comes from the line of Nik Dimitrov with Morgan Stanley Investment Management. Please proceed with your question.

Nik Dimitrov: Good afternoon guys. A lot of my questions have been already asked, but I still have a couple of questions. So Carlos I was looking at your capital, tangible equity to tangible assets excluding the perpetuals and that ratio has been grinding down for a few years now, so currently it is in the 12% area. When I compare Crédito Real to Banorte or Bancomer, that same metric for these two banks is in the 10%-10.5% area, right? And these are much larger entities that are being regulated, more profitable and so on and so on. And I know that we have been doing some share buybacks, they have been relatively small, but nonetheless, how do you think about capital? And again, this is somewhat related to the question that Nick asked earlier regarding your leverage. Do you believe that you need to raise capital?

Carlos Ochoa: Not at this time and the way we see capitalization if you want, is in terms of risk adjusted capitalization consistent with rating agencies, basically that is one key element. If you look at, if you think in those terms, the risk adjusted capitalization stands something around 11% or something. And in order of not having, you know a detour, when to Standard & Poor's methodologies is concerned, in order of not having, not being downgraded or put on credit watch or anything, your risk adjusted capitalization needs to stand above the 10%, so we are well above. However, I mean one of the key aspects, the rationale behind the decision of not increasing the leverage at all these years comes from the side of protecting the capitalization and that is what we are aiming now, that is definitely what we are aiming, protecting the capitalization, not over leveraging the customers, and more importantly, you know, the focus for this year has to be capital allocation efficient capital allocation. So instead of, and that is something that we mentioned at some point, instead of growing what we need is making more money in order to strengthen the capitalization. If this is accomplished, I think we will be okay for the next couple of years, but that is what we are aiming at this point. What I am saying is, to put it briefly, is a more, what we are going to see in the next couple of years is going to be a more disciplined growth. That is basically what we are aiming.

Nik Dimitrov: Got it and regarding making more money. Your margins have been under pressure even prior to COVID-19 and some of this has changed in the business mix, but there were others, there was other things going on. When I look at your net interest margin in 1Q, I calculated roughly 10.5% range and it continued to decline, although, you know, assuming that decline is related to the issuance of the of the new dollar bond. At the end of 4Q, you mentioned that you expect the net interest margin to rebound to the 14% area by year-end 2021, which very much ties with what you just said that you want to emphasize quality versus quantity. Do you still see the net interest margin recovering to 14% a year in 2021?

Carlos Ochoa: Yes. And let me tell you why I see that. If you think about the, you know, about the negative... if you think about the negative carry which amounted roughly 100 million, 110 million or something like that, that is roughly, that amounts for roughly 2% of the pressure over the NIM. So expecting to deploy those resources by the end of the year, you would not be having that 2%. So that puts you on the 12% range loss. The second initiative, which is very, very important as well, you know, in order of, you know of boosting the NIM, it is going to be to move... to change the concentration that we currently have on the SMEs portfolio which as of the end of the quarter stands at the 22%, 20 plus percent range. If we manage to, you know, unwind that to something around the 15% range, which is something we believe that we could do this same year and to compensate this with different lines of business with higher interest rates such as payroll or such as the used cars here in Mexico where we see enormous potential in both businesses. I mean, I definitely believe that only by this product mix and the deployment of all the resources that we currently have, we could be or something around, the NIM could be standing close to the 14% or probably a little bit higher. So basically that is what we are doing.

Nik Dimitrov: Okay, makes sense. And one last question I am going to revert back to that problematic loan. I think in dollar terms it is around 30-32 million dollars. I was a little bit surprised by the size of the loan, I thought your SMEs book was primarily leasing and a little bit of working capital loans, generally kind of more granular than the 30-32 million dollar loan that kind of came up as being problematic. What is happening is this loan like one off in terms of size or a lot of the loans that you originated are kind of roughly in the same ballpark in terms of size?

Carlos Ochoa: No, in that sense, yes, it is above the average, that definitely was above the average. However, I mean, as I have stated, you know, during the call, you know, the particular feature about this one was the default, right? Was the default. So basically what I am getting, what I am having to is that, I mean, bad business decisions we made on a recurrent basis. So what we are aiming now, I mean, is to strengthen all the origination procedures, specifically for the SMEs business altogether in order to minimize them, realizing that bad decisions are, you know, day-to-day thing, just that we are trying to minimize them. That is what we are aiming.

Nik Dimitrov: Okay, got it. Thank you, appreciate it, thank you.

Carlos Ochoa: Thank you Nik.

Operator: Your next question comes from the line of Nandana Shenoy with BTIG. Please proceed with your question.

Nandana Shenoy: Hi, good afternoon. I just had a quick question on your opening statement under the relevant developments and you said your joint venture with Banco Famsa. You have got the receivables coming through an SPV with Promecap and an investment fund managed by Credit Suisse. Can you please walk me through that structure, particularly around the set up of the trust? Is it a single trust is a double trust structure? Do any third parties have access to the SPV And who is responsible for the due diligence behind the receivables and invoices?

Carlos Ochoa: Yeah, I mean, basically for starters I mean, if you think that particular portfolio, the Famsa's portfolio, Bank Famsa's payroall portfolio was something around 11 billion pesos at the beginning of the thing, you know, this started, this whole situation started at the beginning of July last year. So what happens is if you think in those terms, roughly you know, half a billion, that was too big for us, that was too big for us and that would have put a lot of pressure over the capitalization. So that is why one of the key aspects was looking for partners and that is what we did, a couple of players and basically, you know, in order of not having pressure over the capitalization, that is how we we ended up, you know, setting these SPV up and that is basically the rationale behind that, What is going to be the innovation for that particular SPV, probably is going to be more related to the, you know, to the duration of this portfolio and the potential new loans that we could be, you know, granting that is probably two or three years and that is it. What I can tell you, I mean, and something that is proving to be right, is that this was a great business decision, definitely was a great business decision because not only we gain access to the northern states in payroll, which were not within the core in our footprint, but definitely net income wise, it was a great business decision.

Nandana Shenoy: Okay, but do you have details in terms of how the SPV is setup? Is it one SPV? Is it strictly a pass through structure? Do any third parties have access to the cash flows?

Carlos Ochoa: You know, I cannot provide you those details and we can reach out for you to give you further color on this offline.

Nandana Shenoy: Excellent, thank you very much.

Carlos Ochoa: Thank you.

Operator: Your next question comes from line of Matt Dratch with Millennium. Please proceed with your question.

Matt Dratch: Hey guys, can you hear me okay?... Okay, great. So I actually have a question on the payroll section and it looks like the loan portfolio increased almost exactly proportionally with the stated origination around 2.3 billion pesos if I read that correctly. So this kind of implies there were almost zero collections. How should we, how should we think about that?

Carlos Ochoa: Yeah, I mean if you look at the origination and if I understood correctly, the origination what you are seeing in the origination for the 1Q as of the payroll amounted to roughly 2.3 billion, right? That was your question?

Matt Dratch: Yeah.

Carlos Ochoa: Basically thing is that we are over there in that figure the 2.3 billion, we are incorporating something roughly about a billion pesos. Is the, was the bottle of this Famsa's portfolio. Just to, you know, just to give you a timeframe about the transaction that was completed on January, 9th, If I recall correctly that was completed on January, 9th, and amounted on our side roughly a billion pesos. So basically that is why you see the difference or you could understand it (inaudible) of origination and on the other hand, in the size of the portfolio. But this is the case.

Matt Dratch: Okay, and then just one more. Where do you stand on the CRUSA loan from Wells Fargo. It looks like the debt equity has a two and a quarter time limit. And are the proceeds from the ABS deal to repay that lender or where do you stand on that covenant?

Carlos Ochoa: No, look I mean what I can tell you about that particular transaction is that it was, it has been it definitely it is a landmark transaction for the Company. I mean we are lowering the cost of fund dramatically and that is going to be an improvement, an important improvement in the terms of the cost of fund for the company because we are, you know improving something around 200 basis or something like that, something within that range. So that is going to be the most visible effect over the next few, you know, the next few customers. And basically it is what I can tell you about that is that it is an ABS facility, basically.

Matt Dratch: Okay. And then just thinking about the NPL, if you adjust for foreclosed assets and charge offs and relief programs, is the business sort of True NPL higher than the 3.9. Like some other words, like there is all these other types of assets that you do not calculate as NPLs, but like we broadly think about NPLs, as you know, people can not pay, is not it? Is it high? I am just new to this credit so I am a little curious.

Carlos Ochoa: I mean. Definitely probably the best way to see it is, you know, with all the figures available. I mean, if you think in terms of cost of risk, you can see, you know, you get to see the charges off over there in the cost of risk also with the coverage ratios, you know, the decline in the coverage ratio was explained because an increase in the NPL. However, on the other side, I mean thinking about the foreclosed assets, I would refer to, you know, rating agencies methodology if you cannot monetize them, you know fast enough, I mean, what I am saying is that if you cannot monetize them within months of having those foreclosed assets, then those amount as an NPL, you know for Standard & Poor's or rating agencies in particular for rating agencies methodology. But that is it.

Matt Dratch: Right, okay. And then, just lastly on that Wells Fargo thing is just, you know, I was thinking through as you were speaking on the response. Is that... is the is the Wells Fargo loan being repaid from the ABS proceeds?

Carlos Ochoa: Yes

Matt Dratch: Is that because it is a current maturity or is it because it is in technical default?

Carlos Ochoa: You know since we are about to close that transaction today, I could provide you more color next week, Renata will reach out to provide you further color on that one. But what I can tell you is that as of now you know the main benefit is that it is going to be a major improvement in terms of the cost of funds and more sophisticated treasury on that particular business. So we are making definitely we are happy with the team and we are making sound progress within the business in the States.

Matt Dratch: Oh, okay. So do we lose the value of the securitized portfolio but not get extra cash to the Company? Like how does that, how does that look?

Carlos Ochoa: You basically pay down debt if you have the cash for it.

Matt Dratch: Okay. All right, that is it for me. I appreciate your time.

Carlos Ochoa: Take care, thank you.

Operator: Your next question comes from the line of Amer Tiwana with Imperial capital. Please proceed with your question.

Amer Tiwana: Guys, thank you for taking my question. I have two questions, one, the upcoming maturity in step of next year, 170 million. What is the plan you sort of alluded to? You know, trying to do something with it? Whether are you going to tap the markets? You do have a fair amount of cash and cash investments on the book, Would you be using those? And my second question is regarding liquidity of the Company. Where does it stand? You did raise a fair amount of cash in the quarter through your bond issuance. And you know, we are just trying to bridge exactly what happened in the quarter with cash? What was the cash burn in the quarter? Is the second question.

Carlos Ochoa: Right, I mean, if you think in terms of refinancing since the outset, I mean, when, you know, consistent with the strategy of differentiating ourselves of the different players in the sector, I mean, we intended to tap different markets and that was the reason behind, you know, issuing in Switzerland and the CHF in the euro, the dollars and the local market. The goal was, you know, differentiating ourselves from the other players in the NBFI space. As for, you know, so having that in mind, the intention would be to refinance, to refinance that CHF in the swiss market again. However, we acknowledged that given the situation that we are currently living, I mean, probably the markets are going to be, you know, shock for a while as they were during last year. So basically what we are, you know, what we are trying to do is, you know, the reason for, you know, the reason for focusing on the capital allocation and profitability and so on, is to build up our capitalization and to be ready whenever the market opens, you know, for refinancing in particular the CHF bond that is basically our view right now, you know, focusing on capital allocation, focusing on asset quality and so on and so forth. And that is basically going to be the idea. How are we planning to use the cash? Well, at this point we feel comfortable. I mean, we and considering the atmosphere having that amount of cash definitely put us on the right position. That gives us flexibility, that brings us definitely opportunities. And and that is basically where we are standing. So to put it shortly, we having this cash puts us in a place where we do not see refi problems where we see, you know, a natural form of strengthening our financials and that is the good opportunity that we... that is the opportunity that we are standing. In terms of the cash work, I mean, what I can tell you is during the 1Q, what we have net income, positive negative net income, so there was no cash to burn. We got a couple of facilities we issued the 2028 worth 500 million, out of those, roughly 200 probably a 190 million, we stand there for the 2023 in order to having a much better debt profile. And we also got 100 million from the DFC. So basically what we, you know in terms of liquidity, the best way, the way I like to describe, the best way I plan to describe the liquidity of the Company, the position of the Company, is that we do not need new money in order to grow 7%. So I think that is a good way to describe the cash position of the Company. We generate a lot of cash.

Amer Tiwana: Thank you very much.

Carlos Ochoa: Thank you.

Operator: The next question comes from line of Andy Taylor with Carronade. Please proceed with your question.

Andy Taylor: All right, thanks. I guess, it's a couple of questions. Currently are all of your bank facilities fully drawn? (background noise).

Carlos Ochoa: We have the (unaudible) facilities. If you look at the earnings release, if you look at the earnings release in terms of availability in terms of bank facilities, let me get that info right now. So, right now it's about 10%, I think, undrawn facilities, 10% or 15%, something like that, are undrawn facilities. As far as if I, if I recall correctly, we normally kept drawn something around the 90% and as of today I believe that we are a little bit shorter than that. I think it's more like in the sense of 85% or something, at least in the important ones, they are drawn most of them, they are fully drawn in the consolidated should be something around the 85- 90%. But let me check and get back to you on that one.

Andy Taylor: Okay. I guess the question I'm trying to understand is if you have some liquidity there and you're carrying all this extra cash. And it's creating a 2% negative, you know, headline to interest income, why not use that cash? Pay down your facilities, avoid this negative yield and just draw the cash back later. You said you just said you generate a lot of cash, you're carrying excess cash, you have access to liquidity. Why burden yourself with the extra interest expense that you're carrying by keeping cash up?

Carlos Ochoa: I mean, because basically because of the flexibility that having the cash provides us, that's basically the main reason for that. So in that regard, we are assessing the best use of that cash. Remember that we are coming out of the 2020 where, you know, markets were close, you know, markets were killed for, you know, the entire year for us. And basically we're, you know, to put it short assessing the best use of that cash, you know, under the current circumstances...under the current environment...what we value the most are the flexibility in order to capitalize on opportunities.

Andy Taylor: I guess I would just think that if you have the facilities you could pull it back if you need it. But okay. The other question I had was on the acquisition of the payroll loans in January, sort of building off the question was asked earlier. I think the gentleman was trying to figure out what purchase price you guys put them at, I guess, can I ask or can you, you said you can't get into it for detailed purposes...can you at least tell us are the stated balances on the balance sheet consistent with the purchase price or were they written up to notional, stated balances?

Renata González: Yes. Actually what we are registering in our loan portfolio is basically the purchase price we paid for our correspondent part of that portfolio.

Andy Taylor: Okay, thank you. Um, and can you guys tell us, and the other part I'm just try to understand big picture, your efficiency ratio is going up, which means your expenses and other sorts of things are going up. Your NPLs are up, even without the SME loan they're up a little bit, your coverage ratios are down, you're borrowing costs are up and your covenant ratios are close to being triggered. Why are you growing the balance sheet into that? Why wouldn't you shrink the balance sheet and sort of turned into cash and become more liquid?

Carlos Ochoa: Look, I mean, I could elaborate on the pressure over the NIM. You are right, I mean, and the effect that this has over the efficiency ratio. So, we'll just explain the effect of the negative carry that we explained already. Look, you are right, I mean, one of the key aspects as of this year and it is not only at this year at the end of last year is reassessing growth. So basically, I mean, what is important about is that in the past the history of Crédito Real was, you know, the history of Crédito Real was a history of growth. Basically, we are now focusing on growing more efficiently and that's basically where we are standing. I mean we are not discarding, we're not discarding asset sales. For example, we are refocusing just to the use of our capital. I mean, and this is what the idea that I was trying to convey when you, when I say that you will see a more disciplined growth, especially this, this comes out that you know, have all the challenges that we've been facing, including the COVID and so on and so forth. So basically we are reassessing growth in order to grow in a more disciplined way.

Andy Taylor: I guess I'm asking I think a slightly different question, why are you growing, your mentioned that your tangible, the tangible equity is getting low. You have all of this money you set out to other receivables and affiliates as like a precursor to origination, why not shrink the company and liquefy the company and sort of improve these ratios and sort of address these concerns that people are having and improve your ratios.

Carlos Ochoa: That's exactly, you know, that's exactly what we intend to do when we said that we will refocusing, we will be walking to our capital (indiscernible) on what makes sense. I mean, if you think about the rationale behind, you know, trying to unwind the book, you know, to lower the concentration from the 22% we currently have on the SMEs into more efficient portfolios such as the payroll or such as the used cars, that would lead to improvements in all the different metrics. So that's basically what we are aiming and all of these to say that I agree completely with you and that we are doing right and that's exactly what we are doing, you know, refocusing, you know focusing on a capital allocation and that's something that we are considering as we speak now in order to improve the ratios.

Andy Taylor: Okay. It sounds like you're optimizing with mix. I understood that comment before about SME and payroll, I'm saying why not just shrink the book 25% or something and really try to liquefy things or if there's all this money that's kind of spent out and sort of in the affiliates and whatnot. But, can you also just real quick, can you run me why you have to (indiscernible), why you have to send money to off balance sheet affiliate ahead of originating loans to such a great degree. I don't fully understand that you have to...(interrupted).

Carlos Ochoa: Uh, you speaking about the SPV? About the Famsa deal and the SPV? Or, or I don't get it.

Andy Taylor: No.

Carlos Ochoa: Oh yeah, yeah, yeah. You're, you're speaking about, are you speaking about the other receivable?

Andy Taylor: Yes. Why do you have the receivables...(interrupted)

Carlos Ochoa: (multiple speakers) That's related to the payroll business, it's a rebate if you want. I mean if you think that the sale forces get paid on a daily basis, something around 10-15%. Well, basically we advance some cast in order for them to pay the sales forces. That's basically how the business works and that, you know the explanation of that. But if you're (indiscernible), when I spoke about the other receivables was, basically, that it is entirely associated to the, entirely associated, to the duration of the group. If you unwind the book, that line unwind naturally, but basically you advance that money in order for them to pay their sales forces. And that's what it is.

Andy Taylor: I get that there's origination fees. And so, I guess just begs the question again, why burden yourself with all this extra interest expense in the cash drag while forwarding origination fees to people, like why not just stop doing that and sort of allow cash to collect and sort of improve the book.

Carlos Ochoa: By unwinding the book?

Andy Taylor: By unwinding the growth of the book, stop origination, stop sending 10-15% out and sort of just collect cash build up, demonstrate that everything is working...(interrupted).

Carlos Ochoa: I mean, I guess that we are jumping from one side to the other. If you think about the payroll particular business, if we do not spend that money they simply do not originate. I mean because that's money, that money is used in order that used to pay the, you know, to pay the sales forces. That's about it, on the other end and that's what we intend to do in the most efficient, you know, capital wise, the most efficient products such as SMEs. That's basically what we what we intend to do. But those are two different products with two different dynamics.

Andy Taylor: It just seems like you're spending money to push your ratios down and if you were to stop spending money to originate you would put pressure off of your, if everything works according to plan, you would actually save money and allow your ratios to improve.

Carlos Ochoa: Correct (indiscernible).

Andy Taylor: Okay, that's all I have. Thank you.

Operator: The next question comes from the line of Lemer Salah with Barings. Please proceed with your question.

Lemer Salah: Hi, good morning, Carlos. Hello, Renata. Thank you very much for your time. Um, just a few questions from my and so the first question is with regards to that capitalization. I mean obviously the market is not taking into the consideration, I mean, when you look at the pricing of your (indiscernible), probably not going to get caught next year. I'm just wondering like in a minute, 6 percentage points in terms of capital from that 13.14% which were reported at the end of first quarter. Um, what are the thoughts with regards to that? I mean considering the market is extremely difficult and also how does that translate into (indiscernible) capital ratio. In the second question with regards to that capitalization, and then I'll pause so you can answer and then I'll follow up with the other questions, it's with regards that risk adjusted capital, which is roughly 11%. If you add the intangibles, the derivatives and effects where we put that number will land up.

Renata González: Okay. In terms of, if I get it correctly Lemer, in terms of risk adjusted capitalization, some of the adjustments they make to reach that measure is that they put the intangibles, they decrease the intangibles for our equity in order to have a risk adjusted capitalization, as Carlos mentioned as of now we are on levels of around 11% for the two forecast years. And also some of the things that affect that they take out of the equity come from the effects impact (inaudible) derivatives for example. So they basically take out this kind of effect in order to, to measure the RAC.

Lemer Salah: Okay, good. So, so so I understood that, but the question was if you, if you exclude the perpetual, which is 6 percentage points of your capitalization ratio and you learned that 20-25 (inaudible), let's, let's assume it, uh, 25 and then also the delta, the difference in between 25% and 11% is intangible effects and um, derivatives, is that correct? Is that calculation correct?

Carlos Ochoa: No, because I mean when it comes to risk adjusted capitalization, just to remind you that we just got equity credit for 120 million. So that would be the difference, Right? I mean, if you look at the, if you look at the capitalization, I mean that's the figure that were disclosed. If you look at the capitalization ratio (inaudible) excluding the perpetual notes, now reaches something around 23.8% and that's the figure that were disclosed. However, in order to reaching the 11, the risk adjusted capitalization to just get 120 million equity credit for that.

Lemer Salah: Perfect, awesome. Thank you. I got that. So in in a year where your capitalization is because because you have back and back in the days in the previous quarters, you have always eluded that you target at 30% capitalization level because that's where your what's your, what's your comfort level? So how do you envision in a year where your balance sheet growth at 7% uh and they also are on the rise uh you take to your guidance of 3% NPL, which I do like, I was just wondering like, you know, what is your guidance for the cost of risk and how do you envision in terms of accruing organic capital on the balance sheet? It seems like you (multiple speakers) got a trade (inaudible) a lot. You might not be able to to improve your capital ratios.

Carlos Ochoa: Well, I mean, if you look at the, if you think in terms of cost of risk, what drove the cost of risk down in the past to, you know, recall with them saying what was the cost of risk down was the SMEs book basically. So right now, you know, if you think in those terms as of the end of the 2020, what throw the cost of risk up was basically, you know, we have the reverse effect, so what drove the cost of risk up was the SME portfolio. So one of the key aspects about not relying or about the underlying the SMEs book from the 22 something percent, definitely going to be to improve the cost of risk as well. Well from the levels where we are standing right now to something where we, what we do, something that we used to have in the past, when we have an important concentration in the payroll business, which if you recall correctly, was more in the range of the 4%. So my view on that one is that one that we normalize things, you know, the probably the cost of risk is not going to stand at the 3% range which we saw at the end of 2019, but probably going to be more in the, you know, 3.5% because a different concentration in the payroll book.

Lemer Salah: Perfect. Okay. Um, and and just just one follow up questions question with regards to NPL, now you're opening opening entry level, I think it was January 2020 it was 1.7 you're carrying forward those legacy NPLs I'm taking, you know, this radio polish and, and, and the Latest developments out of equation, your starting point it was 1.7 in the first quarter last year. I'm just wondering like, why would you carry forward those, um, those NPLs, can you write off any and what is, you know, I mean roughly for if you have that metric, the write off versus recovery ratio in the, in the legacy book?

Carlos Ochoa: Yeah, I mean, yes, definitely. I guess you could write themselves, I mean, definitely you could write themselves, but that comes with an expense, right? So the reason for having those is, you know, that's a healthy level to carry. So problems the figures that you are saying is that, do you think that on the 1Q, in the 1Q, you know, the NPL ratio stood in 4Q19, the NPL ratio stood at 1.7. And prior to the, to the, you know, to the changes that we made last week with you (unaudible) is isolating the effect of this single account is stood at 1.8. What I'm, what I'm, what I'm hearing is that, you know, the portfolio performed during the crisis performed reasonably well. I guess that we could, you know, reach out those levels, you know, eventually we could reach out those levels and that's what we that's what we are in.

Lemer Salah: Okay, but the question here is actually around... because because the recovery part globally is probably more positive than it was last year. You have got this, this US kickstart on the back of it, in terms of fueling the push through Mexico. So the question is like, at what level and based on which conditions would you write, you know, the excess NPLs and definitely comes at a cost, but I mean back in the days when at the end of full-year 2020 when we asked that question, because your coverage ratio, NPL coverage ratio was 219%, you felt very comfortable, you said like I do want to keep my NPL coverage ratio around 200%, so now it seems like you either need... you cannot write them off because NPL coverage ratio has come down, you need to build that and then write them off gradually. So it feels almost like you do not have that option at hand because because building that until the coverage ratio is more important.

Carlos Ochoa: What do you mean? (inaudible). No, I would not say so because remember that we, the way we provision is based on expected losses, right? So based on that methodology, if you think when we used to have 220% range of over 200%, what basically, what I am trying to explain over here is that the provisions are if you think in those terms is just an input. And as of the 1Q of this year, the coverage ratio stands, yes, well below, you know, well below the standard. But the NPL stands, you know, well above the standard as well, you know. I will feel more comfortable having, you know, NPL something around the 3% range and a coverage ratio, a traditional coverage ratio of something around 150% or something percent. But, but that is, you know, that is what happens as of this quarter. In anyway I mean, what is important here is that we do not want to risk the financial health and we are confident that we can solve this particular issue and we are using whatever tools we have at hand to solve this situation.

Lemer Salah: All right, Gotcha. Thank you so much. I have been thinking of me, I do feel like for 2021 the key focus should be on steering your NPLs down because it almost feels that is probably the crux of your entire investment pieces. Whether you look from it from a fixed income perspective of equities perspective, if you manage to keep that down and address that and potentially write it off wherever you have it possible based on your ECL that could potentially result in positive P&L impact because I also recall the discussions we have at the end of fourth quarter where you said you could potentially release provisions towards the second half of 2021. But that I think I mean that angle seems to be off the table at the moment.

Carlos Ochoa: No it is not. I mean definitely not it is not. And this is, you know, this is part of the tools that I mentioned, you know during follow. I mean there are many ways to do so, I mean some of them was easy to write it up or whatever but at least at this point what we are aiming is reducing NPLs, you know, in a natural way and we are confident that we could be showing some progress in the in the remaining of the first half of this year in and puts on a much better position for the second half. So basically, you know it what I am saying is that as a part of the tools of, you know, handling this whole situation, you could see the charge off as a safe trigger, right? But we are not there yet.

Lemer Salah: Okay got you. But personally, I do not think like even if you, if you lift your NPL bar, if you move it north to a different level, it is not a big deal, but you do need to provision more and and steer it, you know, I mean try to steer it down towards the end of the year. But I got my answer. Thank you so much and thank you for your time.

Operator: Your next question comes from the line of Diego Torres with MCC Itaú. Please proceed with your question.

Diego Torres: Hi, thank you for taking my question. I do have three quick questions that I would like to catch, the first one is regarding the SME loan portfolio. Someone asked previously, what is the amount within the SME group or SME loans, the top 10 largest loan if you have that number handy. My second question goes related in terms of just to confirm the, some figures that you mentioned regarding the this one off loan, that is the provisions at this point is 55% out of the 700 million pesos. And the last one is if there is any limit in terms of the secured debt that you can issue in terms of covenants. Thank you.

Renata González: Yes, I think I will address the first question first. As of today we have provisions that 45% of the loan you are mentioning and the first question, I think it was regarding the ticket size of this loan, which was 700 million pesos.

Carlos Ochoa: Is only 45.

Renata González: It is only 95 million?

Diego Torres: Sorry. you mentioned about the first question or the second question?

Carlos Ochoa: Well, she answered the second question. Where were we are saying that, what we have provisions for this particular credit amongst roughly 400 million pesos, which is 45% of that of that loan. But we have trouble to understand your first question.

Diego Torres: The first question is, how much is the 10 largest loans within the SME segment?

Carlos Ochoa: The what excuse me?

Diego Torres: 10 largest...

Carlos Ochoa: Ahh, 10 largest, yeah sorry. We cannot provide details for those, I mean the information that we provide you is more in terms of the average ticket size that we have and if you look at the, if you look at the figures that we disclosed, you know, in the average, they are roughly 3.5 billion or 3.5 million pesos or something.

Diego Torres: Yeah. Okay. Yes because that is totally off with that loan that you have problems. So it is just like to precise the risk of any outlier or any additional outlier. And the last question is regarding in terms of the secured debt, if you have any limitation in terms of the amount of security that you can issue basically in terms of any covenants.

Renata González: Yeah, regarding the composition of the security debt as of the end of the quarter, around 79% comes from unsecured debt that it is basically the international bonds that we have. And then on the other hand the 21% we have a securitization program here in Mexico which amounts probably the 2% of the total debt that we have and also some credit lines are secure.

Diego Torres: Yeah. But there is no restrictions in terms of the size? I mean you can issue as much as you want or the market can be able to absolve in terms of secured debt?

Carlos Ochoa: No, we have covenants that we are complying with definitely, I mean does exist but in terms of securitization as far as I understand there is something, there is some clauses on the on the senior notes that you have to keep some balance for 10% or something like that, but we will get back to you on that one. In any case, I mean, what I can tell you is that we are complying, we are covenant complying at this point.

Diego Torres: Perfect, thank you.

Operator: Your next question comes from Line of Artem Sunyaev with VTB Capital. Please proceed with your question.

Artem Sunyaev: Hi, thank you very much for thanking my question. The first one is could you kindly give us a bit more color on your (inaudible) practices and principles especially regarding concentration risk. Because I see that is the key problem that was discussed during this call. So we would like to better understand what is the practice and how this practice is allowed to such huge concentration and increase of NPL of SME segment. My first question, thank you.

Carlos Ochoa: Yeah, I mean what I can tell you is that without getting into the specifics about that is that we are bolstering our risk assessment practices. A lot of people is going to, is getting involved, you know, when I say a lot of people are, you know, this can be people you know from the Board, you know by setting or strengthening the credit committee at the Board level and also the credit committee, you know, internally. So basically it is also the type of things that we are aiming right now in order of... strengthening our processes and in order of preventing this situation to happen again. Clearly, there is. I mean there, I could not discuss with you the credit policies that we have, but basically, what we make sure is that we follow the right processes and this has nothing to do with the outcome, right? I mean, whether it is with the outcome, whether it is good or bad, you know, a good or bad business decision, but as long as we, you know, are confident that our processes are right and they are all are followed through. I think it is going to put us in a much better position.

Artem Sunyaev: Well, okay, and the second question is kind of follow up on the first one. Could you kindly remind us please, what is your corporate governance practice between timing of the Audited financial statements release and earnings report? I would like to understand do you and would you able to reduce some gap between financial statements release, I mean audited, and your earnings reports because otherwise it makes and it creates, especially in this case, a great mystery to investors on this numbers and this is a huge problem for bondholders as well. So my question is, do you expect to reduce timing gap between audited financial statements and your earnings release?

Carlos Ochoa: Yes, definitely, I mean basically the, basically we will not increase as I mentioned several times during the call, we will not increase debt for this year. And we are very.... and we have on the other hand, I mean if I understand correctly, your question what we are very strict and to promote audit of all our numbers and basically that is it.

Artem Sunyaev: Well okay I got it. The next question is some kind of technical question, can you kindly give us a bit more details on what exactly is under your investments that is on your balance sheet? You put this balance item to the overall liquidity, so could you kindly give a brief description, what is the kind of instruments for this item? How they liquid, right? And what is the credit risk for for these investments? Thank you.

Renata González: It is basically overnight investments.

Artem Sunyaev: Sorry, could you repeat please?

Renata González: It is basically overnight investments.

Artem Sunyaev: Okay okay, I get it. Thank you very much, no more questions for myself. Thank you very much.

Operator: Your next question comes from line of Gilberto Garcia with Barclays. Please proceed with your question.

Gilberto Garcia: Hello and good afternoon thank you for the call. My question is on foreclosed assets, in your audited numbers in the audited report, you say that this is basically real estate. You also say in the subsequent events section that you gain the right to a further 1.3 billion in two plots of land. Just want to understand is that, is that related to these same foreclosed assets? Because the balance quarter on quarter was flat, so I just want to understand if... what is the situation there. And also, if it is just two blocks of land, it would seem that you have other very high ticket loans in the SME we are talking another 65 million-dollar for these two plots of land. So I do not know if you could provide some color on those. Thank you.

Renata González: Yes, hi Gilberto. Regarding the foreclossed assets it is basically some lands that we executed from guarantees from our clients since since the fourth quarter. So basically in this quarter we are having that same assets registered under this line.

Carlos Ochoa: And we would expect to monetize them some point during this year.

Gilberto García: Okay, but is this... in the subsequent event, you talk about an additional 1.3 billion pesos. Is that just the technicality of now having the legal rights to the previously stated 1.3 billion in foreclosed assets from the fourth quarter?

Carlos Ochoa: No, I think it was if I am understanding you correctly, under the subsequent events, I do not know if you are referring to what we disclosed there during this week.

I mean about the 200 million pesos in the depreciation change of methodology or I am not sure I am understanding because if you look at the foreclosed assets in particular, that line has remained stable for the 4Q and the 1Q. So that is completely isolated from the rest. I am not sure if I am understanding right your question.

Gilberto García: Yeah, I mean, I am not sure I am understanding correctly either. In the (inaudible) 1:48:28last page of the audited statements, you say that in January you exercise guarantees, for you know, two plots of land worth a combined 1.3 billion pesos.

Renata González: Yeah, yes that is the thing that is registered under the foreclosed assets.

Gilberto Garcia: Okay. So it is just a technicality that you have got the legal rights in January, but it is the same assets that you had previously reported in the fourth quarter, correct?

Carlos Ochoa: Yes, correct.

Gilberto García: Okay. And so if it iss just two plots of land, you know, it is 65 million or let us say 30 million each lot. I am guessing this had to relate to specific loans in the SME segment. Would that be correct? Can you say?.

Carlos Ochoa: Yeah, but one of them is divided if I recall correctly in 8 or something like that. So yeah, one of them is, yeah, it is one... so if you, if you want to put it this way, there are like, I do not know, I think it is 9 or 10.

Gilberto García: Okay. In a different subject, just to clarify. Renata you mentioned that you recorded the proportional amount of the Famsa SPV in your payroll portfolio. But is this the book value of the... of your, you know, proportional stake in the SPV or the amount you paid?

Carlos Ochoa: The amount we paid.

Gilberto García: Okay. And so I am curious that tincomes, you know, continues to lag1:50:35 the the growth in the portfolio. And given that you recorded this at the amount you paid, we would have expected that income would would rise materially unless this portfolio was not performing all that well. But the NPL for the segment was basically flat, quarter on quarter. So could you please clarify what was the, you know, the impact in income?

Carlos Ochoa: Yes. I mean there was an improvement in the income and we disclosed that in the press release I think because it amounted for something around 130 million pesos or something over the quarter. I mean the reason you do not see changes in the NPLs for the payroll or in the consolidated is because as I mentioned, that is not on our balance sheet but it is on an SPV is a separate SPV where we are partners along with two other players. So what we see, you know, the amount that we pay, we have looked it on the under the payroll under the payroll line. However, the the whole book is not consolidated into our balances.

Renata González: Yeah Gilberto, and regarding this portfolio, I think it is worth pointing out that it is basically that the same segments that we usually target on the payroll segment basically. So they should be having the average non-performing loan that we also had on this business.

Gilberto Garcia: Okay. A last question If I may on the other receivables. Can you provide any color on when those balances might start to come down?

Carlos Ochoa: As I as I mentioned, you know, the largest portion of them. If you think in that way, the largest portion of the other receivables are entirely associated to the duration of the payroll book, right? Especially if you think in terms of the interest (inaudible) and the income that is paid in advance to distributors and in the risk joint, the responsibility of the distributors, those two are entirely associated to the duration of the book, where all the rest, I mean, the big jump that you get to see is real comes from the account receivable from the subsidiaries and that comes from the consolidation of the Arrendadora, you have the idea of them you have also the other things that should start to come down as long as we are collecting those, facilities from the business.

So what I am saying is if you separate that amount into, if you plead into two, everything that is related to the payroll portfolio, should remain rather stable unless you are also start unwinding the portfolio down. And the other one, the one that are associated to the ones that are associated to all the other lines of business in particular to the leasing definitely are going to come down, is going to argue to start to coming down as we unwind those books.

Gilberto Garcia: Okay. And a follow up on that if I may. On the unwinding the, in the previous quarter, you highlighted that one of the sources of liquidity would be the unwinding of the SMEs portfolio. It was a little surprising that the balance for SMEs actually went up a little bit quarter on quarter, that just a matter of the duration of the existing loans. And, do you still expect to unwind the portfolio?

Carlos Ochoa: Yes, we do and, but yeah, it has to do with the duration and something, but if you look in terms of the origination, it was materially down, no? It came down from the 3.1% at the end of the 1Q last year and right now it stands at something at 1.9 or something. So yes, definitely not going to have the effect of, you know, unwinding that book. And we continue to think that way. We continue to think that we have better use of our equity in the other different lines of business, such as cars and payroll.

Gilberto Garcia: I mean, but what if the goal is people to unwind, Why did you originate close to 2 billion pesos in the border?

Carlos Ochoa: I could provide you more color into that but those are, some of them are renwals or some of them are recurring customers or outside the region, but basically substantially down from what we had last year.

Renata González: Yes Gilberto, and if you compare the portfolio, for example, here in Mexico, you should see that quarter over quarter, the SMEs remained rather stable and the one that had not increased on the quarter was the SMEs on the United States.

Gilberto Garcia: Okay, thank you.

Operator: Your next question comes from the line of Natalia Corfield with JP Morgan. Please proceed with your question.

Natalia Corfield: Hi Carlos and Renata, I think most of my questions were already asked and answered, but I will just like a quick pick some follow ups that I have. In the answer that you gave to Diego Torres on the concentration of your portfolio. Your 5 or 10 largest loans to SMEs, did you like... What was the number that you said?

Renata González: Hey Natalia. Can you elaborate further on this question?

Natalia Corfield: Yes. So it is all about your largest exposure that you said that has worn off, right? So one metric that is good to have is exactly your concentration. So how much your five loans represent of your total SMEs platform, your fiver SME loans represent of your total portfolio.

Carlos Ochoa: We can provide a breakdown of this in terms of customers but the information that we try to provide on the earnings release relates to, you know, not only to the concentration, geographical concentration, but all the... between the different lines of business, no? For example you know 40% of the traditional SMEs that amount for roughly 40% and then you have all the different lines of concentration. We could provide you more color on that but we cannot provide you a breakdown in terms of the customers.

Natalia Corfield: Yeah. No we do not need to know the customers. We do not need to know the customers Carlos, Is the ratio that most of the largest banks they provide for us. It is just that you take the largest loans that you have the five largest and then you see how much they represent of your total SMEs book. We do not need to know who the specific customers are.

Renata González: Okay Natalia, I do not have right now the figure here with me but of course I can provide it to you later.

Natalia Cofield: Fantastic. That would be useful because then we can really see... that we will be able to see if you are that specific loan is indeed one loan that is an outlier in terms of size. That is why that is important, even you if you could even like provide that without this loan it would be great. But anyways anything that you could provide that would be fantastic. And then a question that I think no one asked yet just on dividends. You had said in the previous call that you want to pay dividends I am wondering if this is still holding?

Carlos Ochoa: Yes, actually the ADM approved that we should be paying a dividend on the first half of 2021 of 75 cents per peso, Which is around 250 million oesis. But that was approved, I mean, what is important to mention is that what that corresponds to the 2019 payout and the ADM as Renata is mentioning relates to that. However, at this point, I mean, what we are looking into is how things evolved and you know, best use of our cash and in order of not compromising, you know, the, not compromising the financial situation of the Company. So it is going to be entirely related to the financial health of the Company.

Natalia Corfield: Okay. And some questions just to refresh my memory in terms of your perpetual I understand that the interest rates does not go through the P&L. Am I correct on that?

Renata González: Yes, you are correct. The coupons are registered on the equity given the equity treatment of the perpetuals.

Natalia Corfield: Thanks Renata. And on the loans that have been under (inaudible). My understanding is that you are not accruing interest on those.

Carlos Ochoa: On what loans excuse me?

Natalia Corfield: The loans that are under (inaudible) measures, the ones that are not paying coupons.

Carlos Ochoa: No, no, we are not accruing interest. No, we are not.

Artem Sunyaev: Okay okay, I get it. Thank you very much, no more questions for myself. Thank you very much.

Natalia Corfield: Right. And then finally, so just to recap something that I understood in this call and something that you have been saying for a while. In terms of your SMEs business at the end of the day, we should see a deceleration and I do not know are you planning to be completely out of this? How how are you thinking about the SMEs?

Carlos Ochoa: No, we should see improvement. I mean definitely we should see improvement. As I mentioned at some point in any case. I mean the origination of regarding in Mexico has been improven and we are trying to strengthen all the processes as I mentioned. But definitely I would inspect deterioration in that one. I only know what I can say, what I can say at this point would be that you can expect to see a different conversation of our our book definitely. And being very emphatic about this part is that the focus will be the best use of capital and to keeping the most profitable and best products as well.

Natalia Corfield: Yeah, I think my question was more like I think I am understanding that you are going to gradually phase out from this business. It will be less relevant for you.

Renata González: What we are expecting on the SMEs is to downsize this segment. So basically what we we will be very prudent on the origination throughout the year and we are expecting that at the end of the year, the concentration of the SMEs segment here in Mexico should be around the 15%-16% of the consolidated portfolio.

Natalia Corfield: Okay, those are all my questions. Thank you.

Carlos Ochoa: Thank you.

Operator: Your next question comes from line of Cyril Battini 2:03:08 with Julius Baer. Please proceed with your question.

Cyril Battini: Yes. Hi, good afternoon, Carlos and Renata. So I have again, thank you for the detailed answer and for the time you are taking and your candid attitude towards responding to all of this question on this call. So, I have I guess three very simple question. Two of them, refer to the update on the COVID-19 situation. So you say that in the first quarter of 2021 there was 7.8 billion of collection. How much collection was there from the payroll portfolio? Out of this 7.8 billion?

Renata González: It is around payrol...l on a quarterly basis, Payroll collections among roughly 2.2-2.1 billion pesos.

Cyril Battini: Okay, so from the 7.8 billion that was collected in the first quarter of 2021, about 2.1 billion came from the payroll portfolio. Is that correct?

Renata González: Yes that is correct.

Cyril Battini: The second question, if you look at the other bar chart on the same page is where you show the percentage of the relief program. If you could just walk take one payroll loan and if you could walk through the life of that payroll loan, what determines when it goes into the relief program and what determines when it comes out of the relief program?

Carlos Ochoa: So the relief programs are as of today are entirely related to SMEs, I mean, and actually, you know, most of the, you know, most of the... practically entirely all of the relief programs or none of the relief programs affected the payroll business. Well, there was a time during the year, you know, it was in the second quarter, when there was some some form of relief program for the pensioners but as of today, none of the relief programs affect, you know, affect the payroll business. They are entirely associated to the SMEs business.

Cyril Battini: Okay, good. And so is the decision to move along out of the relief program. Is that rule based? if it is rule based, what is the rules? And if it is case by case basis, what is the thought process for moving the loan out of the relief programs.

Carlos Ochoa: It is case by case and normally what happens, and what happened last year specifically is that we started by mapping out the segment that we believe that were more affected by the crisis and trying to define, you know, a relief program, you know, consistent with the situation of each customer. So the 2% that we are seeing as of the end of 1Q are mostly those, you know, businesses affected by the lockdowns at the end of last year and at the beginning of this year, for example, you know, businesses in tourism that are still affected by this and things like that. But in any case, the message that we are trying to convey here is that it is in a case by case basis and it does not follow a particular rule. It is given the knowledge that we have of the customer.

Cyril Battini: Okay, understood. And my last question to do with the repurchase of shares on the market, maybe if you could just explain to us what was the thought process of the rationale for that use of funds?

Renata González: Yes. Actually, we buyback shares on a constant basis. Right now we thought it was a great timing in order to repurchase some shares. As of the end of the quarter, it was around four million shares that we have right now. We stop replicating given that we entered the blackout period, but the rationale behind this will be to continue throughout the year supporting the share price.

Carlos Ochoa: But in any case, what is important is that the key aspect and similar to what we said, you know, regarding the dividends and things like that is that we will not be compromising, we will not be compromising capitalization by weakening through the buyback program or things like that. The focus will be the financial health of the business.

Cyril Battini: Okay, thank you very much.

Carlos Ochoa: Thank you.

Operator: Your next question comes from line of Miguel Garcia with Citi. Please proceed with your question.

Miguel Garcia: Hi can you hear me?... Most of my questions were also pretty much answered before, but I wanted to see if you could provide a bit more color as in terms of collections and how they are trending, post the quarter close. So basically quarter-to-date. And the second question is, what is the best case for the perps? Is this still to refi at the next call? And would you be okay still with the rating agencies if it loses the equity treatment?

Renata González: Yes, of course, I will elaborate on the collection side. Actually, you could see that during the quarter we have a decrease on the consolidated collections, but it was mostly on the SMEs side, given that the other line of businesses were performing very well during the first quarter. And almost in all the business lines such as Instacredit in the United States and payroll we are seeing a better performance on the collection side. So basically the decrease came from the SMEs.

Carlos Ochoa: And as for the first part of your question, yeah, the best case would be to refinance at the call and the rationale behind that is not losing equity treatment, not losing a equity treatment, that is basically the rationale behind that. So, what I can tell you, you know, as a such, as a best case is that yes, we do have the intention. We like the instrument. I think it was very positive for the company. And if there is a market for for one of those, I mean, we definitely would like to refinance it with a similar instrument.

Miguel Garcia: Just a quick follow up, with the dividends on the table and sure buybacks with the current level of the perps given the high discount. How do you, how do you rationalize that?

Carlos Ochoa: I do not know, I mean, let us..., if you look at the, you know, the sharp movements that the perps had over the last two weeks, we would expect and that was something that we saw during the last year as well. So, and as I was telling you, you know, if there is a market those, yes, that would be our best case to refinance that with a similar instrument. But yeah, we are well aware that there are a number of factors that could affect that decision and we will think all the alternatives moving away from the main stage, right?

Miguel Garcia: But I mean, in terms of capital allocation, do not you think maybe it makes more sense to you know try to address those given the the magnitude of the discount?

Carlos Ochoa: Yes. However if you get into that you know for example buying back the perps at this point I understand, though I would have to review that. I would understand that you weaken your capitalization whenever you repurchase the perps. But definitely I understand that part of the huge discount and the profit that you would make, but as far as I understand there is a you know there is a flip side to that related to the capitalization, that affects the capitalization.

Miguel Garcia: Okay thank you. Thank you.

Operator: Your next question comes from line of Jose Saracut with Manulife. Please proceed with your question.

Jose Saracut: Hi, hello, thank you. I think all my questions were already answered. Perhaps a comment I should may, first of all, thank you very much for making an effort here to clarify things. Now, however, I wish that the press release you guys put could have come at the same time you actually put the the audited statements on Saturday night. That would have clarified certain things.

Carlos Ochoa: Yeah the press release, yeah I mean let me tell you something about that because that is something that we have been you know that we have been thinking about. For starters now we are convinced that we underestimated the reaction. We underestimated the reaction of when that happened. The reason for that, I mean our rationale at the time was we would address all the situation during this call, that was the rationale behind that. We did not disclose anything, we did not go out because we were you know trying to address the whole thing during this call. So in that regard, yes, we are guilty of underestimating the whole situation. However, once that we perceived that we believe that we reacted quickly, I mean, because there was a big misunderstanding, I mean, definitely there was a big misunderstanding and we addressed this big, big misunderstanding rather quickly during Tuesday and that is basically what we are standing. I mean, in any case, yeah, I think that the most important aspects of this, is to be emphatic, this was not a restatement. And rest assured that we are, you know, everyone, rest assured that we are in a strong position and definitely our business model is solid. That is where we are trying to convey, acknowledging the two things that I just mentioned, you know that at the beginning we underestimated the effect and we are guilty of that.

Jose Saracut: I appreciate that, I appreciate that. You know from my point of view as an investor, I can live with higher NPL you know, things happen. The pandemic happened. No one was able to forecast that ahead of time, right? But the credibility is very, very important in the business. So I appreciate that and you recognizing that fact. Thank you very much.

Carlos Ochoa: Thank you.

Operator: Your next question comes from line of Max Bossino with Bybrook Capital. Please proceed with your question.

Max Bossino: Hi Carlos and Renata, thanks very much for taking the time and for taking my questions. Just a couple to start on the audit please. On the reclassification of the large SME loan, I mean, why did that only happen with the audit? Why was that not already taken into account for the, you know, the original unaudited 4Q results. What changed in the meantime?

Carlos Ochoa: Because it was not 90-day past due, that was the main reason. This was loan that effectively was past-due but it was not 90-day past due. So if you if you think about the NPL definition that we have is 90 days to 280 days, that is basically it. So basically, I mean what... I am now moving into the second part of the explanation. Why it was why it was recorded as an NPL? Because the original structure was a bullet, it was, you know, a 4-months if I recall correctly, was a 4-month facility with a bullet. And the auditors, you know, following what we perceive as the most following, the most strict standard, they decided that it should be treated as an NPL, and that that was basically the case you know, it was not 90-day past due. So it was, you know, the auditor at least, for this particular credit was very stringent on how to be, how this needed to be accounted.

Max Bossino: Right, okay. And that, I mean besides this, obviously a large loan which had, as you say, you have discussed it before and had obviously quite a lot of media attention as well. I mean, did you have other loans in the book that are in a similar state of past-due, but not 90 days past-due? And how do you, how do you look at those? Do you have a certain bucket for them? You know what roughly is the proportion of those?

Carlos Ochoa: Yeah, if you look at the at the difference between the 3.3% and the 3.5%. That was, sorry I mean, I am speaking about the 4Q figures and the 1Q figures, if you think about the difference between the 3.3 NPL ratio for 4Q and the 3.9, those are it.

Max Bossino: Right, but I mean on an ongoing basis, I mean at any point in time you will have past due loans as well in addition to the NPLs, right? So, you know, in addition to the 3.9%, what at the moment would be your past-due, but not more than 90 days past-due. What proportion of the loan book?

Carlos Ochoa: I do not know because there are 3, I mean when we speak about NPLs, there are... we are only speaking about those 90 days. So if you ask me, those are more like operational figures. I mean our teams over here in the different lines of business they are, you know, monitoring those loans, you know, since day one past-due they start monitoring those loans but as for NPLs or accounting policies, I think we just followed from 90 onwards. It would be, I mean, getting into the operational business details.

Max Bossino: Right, It is just, you know, from a monitoring and risk management perspective, you know, of course the past few loans are the ones that are most likely to become NPL, right? So I imagine it is something you should monitor on an ongoing basis to assess the potential incoming delinquencies.

Carlos Ochoa: Okay. Yes, we definitely do. And this I can answer you as a collector because I believe that I am more collector than anything else. And yes, we start monitoring from day one and there are different strategies depending on the different business segments right now, given that the focus of the Company is on the asset performance we are very strict, you know, we are very stringent since day one, in all the different lines of business. And the message here is that collection is our top priority at this point.

Max Bossino: Right, okay. Just another question on the audit, is because I think you gave two explanations right. Which are, you know, this one bad SME loan, which was moved to non-performing and also the change in the deep depreciation schedule from the auditor. But I noticed that there were other large movement in other lines, I mean, interest expense for example went up 7.5% on the numbers I have from a Q4 to then the audited full year. Again, looking at the full-year 2020 basis. The investment securities balance was taken down by 7%, I mean, there were movements elsewhere on the P&L and the balance sheet that I cannot understand from just those two items. So were there other adjustments? And if so, you know, what were those? You know, what explains these other movements?

Renata González: Yes, of course. Hi Max, the difference in the interest income and the interest expense regarding what we disclosed previously on the fourth quarter, is that for an investor presentation, what we do in the earnings release is that the exchange impact if it is again or a loss, we register it under the interest income in order to be consistent throughout the period. But on the audited financial statements, what we need to do is that if we have a foreign gain, we are going to register it under the interest income and if we have a foreign loss we registered under the interest expense. So it is basically that.

Max Bossino: Right, but so then you are saying it was really an FX move and it shows up in the interest income and expense lines rather than below those as it would in the quarterly's or is this all happening within the net interest income line?

Renata González: No. as I mentioned for the earnings release for investors, what we do is that we reclassify any gain or loss, exchange gain or loss, under the interest income line. On the audited financial statements, if it is a loss, we are going to register it under the interest expense and if it is a gain, you will have it under the interest income. On 2020 given that we experienced a foreign exchange loss, you could see that the interest expense was higher.

Max Bossino: Right, okay. And that FX gain or loss, I mean, is that on the asset side or the funding side? In terms of how it affects those, those two lines?

Renata González: It is regarding the balance sheet exposed positions.

Max Bossino: And so the FX gain or loss, I mean, presumably this is mainly on the funding side rather than on the asset side, right? But I am just trying to understand why, you know, an FX gain on funding would show up in interest income and equally, uh, yeah.

Renata González: Yeah, It is on both sides, actually. If you want further explanation about this, we can gladly chat later, but it comes from both sides.

Max Bossino: Right, thank you. And my final question is just on the, on the payroll segment. I apologize that this is a stupid question. but you report 55.5% average interest rate and it is roughly 31-32 billion pesos total portfolio. So why is the total income in the quarter only, you know, 1.37 billion pesos, which would suggest a much lower interest rate.

Renata González: Yeah, the most important thing is that you need to remember that we have an agreement with our distributors where we share the 50% of the income and the risk. So that is why you can see that if we charged an interest rate to the client of 50%, we normally have a yield on levels around 20-25%.

Max Bossino: But the so you share the 50$ of the income with the distributor, but I mean, the funds are advanced and formed by yourselves, right? So do you take all of the funding costs, but only half of the interest income?

Renata González: Yes, that is right, we have the funding side. But on the other hand, the distributors absorb all the operation expenses, like bringing the commissions to the field representatives, etcetera.

Max Bossino: But even then, if I do the simple numbers, I mean, I get to a sort of yield close to 17%, which is, you know, is even less than half of the 55.5%. I mean, are there are other adjustments in there? More than 50% share of income that is been paid away or what explains the difference?

Renata González: Yes, the difference that we are having regarding the yield, for example, one year ago were like several factors that affected payroll overall. That is why you could see a decline on the yield, however, we are seeing right now a stronger performance on the payroll side which is pushing off the the yield of the business right now. And we are expecting that given the concentration on the focus we are having in enhancing this business line, the yield should be pushed forward throughout the year.

Max Bossino: Okay, but just to understand just specifically on the first quarter. So if you report the 55.5% interest rate, but if I divide that by two on a single quarter basis, I mean it would be a higher number than the interest income you report in that segment, quite materially. To do it another way I take the 1.37 billion of income, you know an annualized that I get to a 17% yield, not a 27% yield. So what explains that that difference?

Carlos Ochoa: Look, given the nature of your questions, we definitely can address this explanation off line, we definitely address this explanation off line. So let us get back to you and I will follow up with you Alex in order to get these all questions and all the explanations. Thank you so much.

Max Bossino: Thank you.

Operator: Ladies and gentlemen, we have reached the end of the question and answer session. Thank you all for being in today's conference call, and we apologize for any technical difficulties. You may now disconnect.

Carlos Ochoa: Thank you all.

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