2Q20 Earnings Call Transcript

July 23rd, 2020

11:00 AM CT

Operator: The following is a recording for Crédito Real second quarter 2020 earnings call on Thursday, July 23rd, 2020 at 11:00 AM CT. Good morning, and welcome, everyone, to Crédito Real's Second Quarter 2020 Earnings Conference Call. Crédito Real issued its quarterly report on Wednesday, July 22nd, 2020. If you did not receive a copy via email, please do not hesitate to contact us in Mexico City at +52-55-52-289753. It is important to note that the presentation and MP3 recording referred to in this call will be available at www.creal.mx. Before we begin the call today, I would like to remind you that the information discussed in today's call may include forward-looking statements on 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 statements. With us this morning from Crédito Real we have Mr. Angel Romanos, Executive Chairman and CEO, and Mr. Carlos Ochoa, Deputy CEO. They will discuss on the more important strategic financial and operating aspects of the second quarter 2020. I would now turn the call over to Mr. Romanos.

Angel Romanos: Thank you, operator. Good morning everyone and thank you for joining us today. Before starting, on behalf of Crédito Real and all of its employees, I offer our sincere solidarity for all those who have been affected in some sort by COVID-19 and the health professionals whom have sustained our society with their relentless commitment amid this unparalleled environment. To face the pandemic, we have proactively responded to the arising challenge; having the well-being of our associates, clients, and partners as our top priority, while adopting all required protocols to guarantee the continuity of operations. In this regard, by the one hand, our team, distributors and commercial partners, have jointly walked the talk by thoroughly meeting our customers' needs, under a tailor-made approach; effort reflected in the resiliency of the collection and delinquency metrics this quarter. On the other, we have received a positive response of our customers, as most of them have timely met their payment schedules; and, those who have faced some struggle, in the great majority of the cases, have recognized all liabilities acquired and received a flexible payment proposal according to their very needs. To put the importance of these actions into greater perspective, we have kept most of active accounts before the pandemic as of quarter-end. In this context, growth dynamics of the consolidated portfolio were largely dictated by the disruptions of the health contingency, with varying degrees of affection by region and segment. Although, asset quality pretty much remained still, thanks to tighter origination standards oriented only to existing clients of solid credit records or AAA-profiles, for new credits, in addition to the success attained by the programs of support. All-in-all, the consolidated portfolio, supported by the addition of high-quality asset in the last twelve months, expanded by 29% during this quarter. Performance followed weakened origination dynamics across all business segments resulting from both the effects of COVID-19 and the implementation of a selective origination strategy, as we strongly privileged the asset quality. In Mexico, the overall portfolio growth in the country stood at 26% year-over-year, compared to the 20% recorded in the first quarter of 2020, and delinquency remained at 1.5%, slightly eroded by 40 basis points; variation that seems quite healthy when realize the magnitude of the challenge as the pandemic has taken a toll on the economic activity of the country. Payroll portfolio increased on an annual and sequential basis by 9% and 2.0%, respectively, where especially outstanding was the effectiveness of the enhancements performed at alternative channels, such as online platforms and call centers, as usual origination activities were highly limited by lockdown measures. Separately, SMEs operating portfolio in Mexico increased over a 100% year over year, due to the development of our leasing factoring and traditional loans business in the last twelve months. Especially in this segment, the closeness maintained with the clients and implementation of relief programs, helped to preserve adequate collection levels 05:35outbid we are moving forward with special cautiousness as the situation advances. Here, it is important to remind that, over the quarter, we increased the stake in our business of leasing “CREAL Arrendamiento”, taking control of the subsidiary. As a result, Crédito Real became the majority owner and it is now bound to fully consolidate this business into the Company’s Consolidated P&L and Balance Sheet. These new accounting recordings will contribute to transparency and have a nil effect at the operation, as this business line was already consolidated into the Company’s platform. Likewise, it is relevant to note that both SMEs and Payroll started to show a regained traction in June, with the transition from a social lockdown to the reactivation of certain productive activities. At for Used Cars Mexico, the portfolio growth posted a 10% annual rate, but decreased by 5% in a sequential basis. This result was combined with a slightly increase of 10-basis points in delinquency, attributed to the deterioration of the unemployment rate and surging uncertainty, factors that are leading consumers to delay purchase decisions. Nevertheless, at the end of June, origination for Used Cars in Mexico started to show signs of improvement, as public transportation has been somewhat replaced by used cars, given the contagion risks of COVID. In a nutshell, although economic weakness in Mexico is likely to extend towards the second half of the year, we certainly identify positive drivers in the USMCA agreement and a lower reference rate environment, as there are forecasts anticipating that the reference rate will converge to the 4% mark in the months to come. Turning to our international operations, Used Cars USA portfolio’s surged 61.0% year-over-year, but increased only 2% on a sequential basis, following positive origination dynamics over the last twelve months, with a non-performing loan ratio that remained solidly stable at 0.9%; reflecting the resiliency observed in collection. It is important to mention that businesses in the United States started to show some signs of recovery since May. For instance, June posted solid figures in California, almost in the same...

Operator: Please remain on the line we have lost our speakers... (background noise)

Angel Romanos: Sorry about the inconvenience, but my line dropped, I am on a cellular phone and the line dropped. I am sorry, I will continue where I left. It is important to mention that businesses in the United States started to show some signs of recovery since May. For instance, June posted solid figures in California, almost in the same levels prior to those recorded before the contingency. In this sense, underlying this softer impact from the Coronavirus in the United States, we find the financial aid packages approved by the Trump administration and a loose monetary policy. However, the recent rise in infections, after the reopening of the economy, poses a significant risk that we will be diligently monitoring, to quickly execute and monetize credit guarantees, as we just did at quarter-end, when we raised additional cash through the auctions of recovered vehicles. Lastly, in Instacredit, portfolio increased 24% versus the same period last year, while growth struggled on a sequential basis dropping by 3%, as COVID-19 containment measures dragged on economic activity mainly in Panama, and Costa Rica. However, collection improvements were supported by the economic reopening by mid-May. Moreover, adjustments performed to origination standards, privileging personal loans to employees helped to offset the deteriorated consumption environment. Now setting broader color on quarterly developments. In June, our stock was included in the new ESG index launched by the Mexican Stock Exchange composed of the most representative issuers that seek thoroughly to comply with relevant ESG investment factors. This important milestone reflects our lifelong commitment to adopt and promote best practices in governance and sustainability. On the financing front, during the quarter, we have made major strides towards the diversification and expansion of our funding sources. In this sense, we signed a 50-million-dollar credit line with BNP Paribas and successfully renewed two credit lines for 2.2 billion pesos due 2020, which resulted in an enhanced schedule of maturities. In April, we launched a Medium-Term Note Program for up to 1.5 billion dollars, which will grant us access to a wide array of debt issuance options among different markets, currencies, and maturities. It is important to highlight that this program was rated “BBB-” on global scale, making it an investment grade security by the Japan Credit Rating Agency. Shifting the discussion to Guidance, for the time being, we do not count on the elements required to provide a proper forecast, given the unprecedented evolution of the pandemic, which continues impacting the world, mostly in the American continent. Although, we can certainly share that collection and delinquency levels recorded this quarter have positively exceeded our expectations, as our clients have shown a high-level of commitment with their acquired liabilities and shown a good response to the relief options offered. To conclude, so far, we have walked the talk, by executing quick actions to mitigate the COVID-19 effects in our operations, drawing from our sound financial position and flexible operating structure. Before ending my participation, I would like to highlight that this very morning, we announced a strategic alliance with Grupo Famsa, where Crédito Real will bring forth its underwriting experience and wide access to funding to support payroll origination for approximately 3.5 billion pesos per year, tapping into the extended network of Grupo Famsa, mostly at the North of Mexico. This is a big milestone for Crédito Real, as it may almost double its payroll business in the coming years. And, consequently, supporting Grupo Famsa to stabilize its funding needs for this high-quality segment of credits, after the withdrawal of its banking concession, thus allowing to preserve its valuable business generation, while help us to pursue our very target of financial inclusion in Mexico. Now, I want to hand the call over to Carlos, who will discuss on further detail on our financial performance. Thank you again, bye bye.

Carlos Ochoa: Thank you, Angel. Good morning and thank you all for participating in today's call. Taking up what Angel said on the leasing business, our financial statements, as of this quarter, already consolidates this operation. For such reason, there is an additional analysis that includes pro-forma comparisons of key metrics at our earnings release, that should continue over the next quarters until a comparable basis be reached. Now, moving in my usual financial discussion of results. As of quarter-end, interest income reached 2.4 billion pesos, compared to the 2.9 billion pesos recorded during the same period last year, decreasing 16%. This contraction is attributed to several factors as weaker dynamics by the enforcement of restrictions on economic activities and lockdown measures, the develop and deployment of relief programs for our clients which probably represented 9% of our total loan portfolio and the consolidation of Crédito Real Arrendamiento as its main source of revenue is now recorded in other income from operations. With Crédito Real Arrendamiento consolidation we began disclosing some additional figures to reflect all our operations. One of these metrics is total income that includes the revenues of all our businesses, which amounted 2.8 billion pesos at quarter end compared to 3 billion pesos in second quarter 2019 pro-forma. During the quarter, interest expense totaled 1.2 billion pesos, increasing 7% when compared to the 1.1 billion pesos recorded in the same period last year. This variation was mainly attributed to FX fluctuations on the semi-annual coupons paid of certain debt securities, as well as the obtention of an incremental funding, as we pursued to widen liquidity for the reminder of the year, to overcome the cycle. Consequently, the financial margin amounted to 1.2 billion pesos in the reporting quarter, an annual decrease of 31%, as this metric was affected by a lower interest income and by the change in recognizing the leasing and factoring revenues in the operating results given Crédito Real Arrendamiento's consolidation. It is worth noting that the international business contribution to the consolidated financial margin amounted this quarter 74%. Net provision for loan losses totaled 404 million pesos, up 59% when compared to the 254 million pesos recorded in the second quarter 2019, due to the additional balance that was preemptively created since the last quarter, amid the potential effects of the Coronavirus on delinquency. In this regard, Provisions for loan losses as a percentage of total loan portfolio has stepped up from 2.5% in the second quarter 2019 to 3.3% this quarter. Meanwhile, administrative and promotion expenses of the quarter totaled 940 million pesos, increasing 10.3%, following the recordings of depreciation expenses of CREAL Arrendamiento, which were partially offset by the savings generated from the divestiture of Resuelve; the postponement and cancellation of non-strategic advertising and marketing activities; and, the reduction of most discretionary expenses, all as all. In the bottom line, net income amounted to 131 million pesos, compared to the 492 million recorded in the second quarter 2019, following a weaker top-line performance, but remained in the positive zone, without an erosion impact to our cash position, that we consider a paramount metric. In this sense, Return on Average Equity was 4.9% year to date 2020, and excluding the Perpetual Notes effect, it was 6.5%. The Return on Average Assets year to date 2020, stood at 1.3%. Regarding the Capitalization Ratio, accounting for our total operating portfolio, went down from 39% at the end of second quarter 2019 pro-forma to 34% as of June 30, 2020, still remaining within a healthy threshold, and above the average level recorded by regulated financial entities. The funding cost recorded a 4 percentage points decrease, from 13.2% at the second quarter 2019 to 9.1% as of June 30, 2020, primarily reflecting the downward adjustments for reference rates over the last twelve months and by better conditions that range in our debt throughout the last 12 months. On a sequential basis, funding cost decreased by 30 basis points. In this regard, we anticipate worldwide monetary policy conditions and current economic outlook to continue fueling an additional easing, thus opening up windows of opportunity to develop new funding relations. Turning to our portfolio performance. As of quarter-end, the consolidated operating loan portfolio was 51.9 billion pesos, posting a 28% annual growth, as the momentum attained in origination during the second half of 2019 and most part of first quarter 2020 more than offset this quarter’s softer origination dynamics. On the SMEs business, its operating loan portfolio was 10.6 billion pesos, up over 100% when compared to the figure recorded in the same period last year, with most of the growth coming from our last twelve months expansion in Crédito Real Arrendamiento. Next in order, Payroll portfolio totaled 29 billion pesos, increasing 9% year-over-year, with a stable collection. At this point, I would like to mention that our alternative origination channels, such as call centers and online platform helped to partially offset the affectation of field operations of our distributors. Meanwhile, Used Cars in Mexico portfolio increased 10% when compared to the second quarter 2019, amounting to 1.4 billion pesos, by the shift in demand in used cars. In our operations in the United States, the Used Cars portfolio reached 2.7 billion pesos and the SMEs portfolio totaled 1.8 billion pesos, increasing 61% and 130%, respectively. Both benefited by the implementation of operational efficiencies and government stimulus measures. Lastly, Instacredit's loan portfolio hiked 24% year-over-year as of quarter-end, to 5.8 billion pesos, with a month-over-month improving collection. Concluding with the P&L discussion, it is important to highlight our consolidated non-performing loan ratio that remained virtually unchanged, reflected timely implementation of mitigation strategies to cope with the global pandemic, the extraordinary measures applied in Instacredit as well as the increase in the charge-offs experienced during the quarter. Now Turning to our balance sheet. As of June 30, 2020, total assets increased 38%, compared to the same period of 2019, amounting to 75 billion pesos, attributed to the consolidated portfolio growth and larger debt incurred over the last twelve months. As of quarter-end, the Company's outstanding debt totaled 53.0 billion pesos, up 51%, mostly explained by the effect of the peso depreciation applied to our dollar-denominated debt, the placement of our Senior Notes due 2027 and the third debt issuance under our securitization program and credit facilities disposed from March 31, 2019 to quarter-end. Building on Angel's about our new Medium-Term Notes Program, in contrast to the traditional facilities, this program and its comprised securities will provide Crédito Real with a steady funding, according to its needs, while also allowing it to take advantage of opportunities from attractive interest rates in different markets and currencies. It is also relevant to underscore that the sum of strategic financing activities conducted so far, coupled with a stable collection and more limited but controlled origination, support our liquidity to navigate the effects from COVID-19. To conclude, as of quarter-end, Stockholders' equity totaled 18 billion pesos, an annual increase of 12%, result of the already explained factors. With this, I conclude my remarks. And now let me turn back the call to the Operator to open the line for Q&A.

Operator: Thank you. Ladies and gentlemen to ask a question, please press *1 on your telephone keypad 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. Again, that is *1 to ask your question. We will take our first question from Ernesto Gabilondo of Bank of America.

Ernesto Gabilondo: Morning Angel and Carlos, and thanks for taking questions. My first question is if you can provide more details on this alliance with Famsa. From what I saw in your press release, you are going to become Famsa's financial provider for payroll loans and durable good loans. So, I just want to understand what is Famsa obtaining from this alliance? Are you going to share part of the financial profit in Famsa? Or are you going to provide them a fee? Also, are you going to charge Famsa's clients the same interest rates that you are charging in the Crédito Real's products? And I remember you even took out alliances and exclusivity with retailers. If I am not mistaken, they were Hermanos Vazquez and Viana. So here, you have the experience in attending this type of client, but why did you stop lending to retailers? And why are now you seeing another opportunity to grow in this segment? Thank you.

Angel Romanos: It is a great opportunity for us to work with Grupo Famsa. They originate in payroll loans, almost the same as we do in a monthly basis. We have a large sales force on the streets. And we know most of the government agencies where they do their payroll disposals and their collections are very similar to ours. On the commercial side, we are working, and yes, to another question you made, we are sharing income with them as we do with all of our favorable lenders on our payroll distributors. On the commercial side, we are going for a fixed ROA. After our cost of funds and our operating expenses and losses, we are seeking an ROA that we determine with them. And the rest of the income will go to them. But we are not thinking really any risk on the portfolio or an individual cost. So, for us, it is a very big opportunity, it is a very huge growth opportunity, and we believe that we made a good arrangement, a win-win arrangement with Famsa. We will allow them to keep working on their commercial business as their license bank was taken from them. And we will be the credit providers if you can say it like that.

Ernesto Gabilondo: And can you share with us this target ROAA that you are seeking?

Angel Romanos: I prefer not to because then you put it on your models and you believe we are going to make more money than Banorte, and that is not true.

Ernesto Gabilondo: Okay. No. Okay, understandable. Then I have a couple of questions about the quarter. The second one is on the expectations of loan growth. How has the lockdown affected your distributors to originate new loans at government institutions? Are you already originating new loans? What is the percentage of your sales force that has come back to the streets and is approaching again government institutions? And then my other question is in terms of non-interest expenses. As you pointed out, most of the growth was explained by the depreciation related to the consolidation of the leasing business. However, this depreciation is expected to remain through the rest of the year, right? So how should we think about the non-interest expenses line growth in next quarters? Thanks.

Carlos Ochoa: Hi Ernesto. Well, when it comes to your first question, in terms of the origination specifically on the payroll business, clearly, it was softer. I mean probably that is the softer origination that the company has experienced in a number of years. However, due to this new arrangement that we have with Famsa, we are convinced that whatever we lost in the first half of the year, we could offset it in terms of origination, we could offset it in solvency once that we start operating with them. So, I think it is going to be all in, I think it is going to be a positive year in terms of origination as for the Payroll business altogether due to this new alliance.

Nowadays, what we have been doing lately, as we mentioned during the call, is to rely on other channels. I mean, if you know, the... clearly, what our customers value the most is service, and the service provided by our sales force. However, due to the lockdown measures, we have to rely on the origination to other channels, mostly contact centers and online platforms and so on. They amounted for roughly 45% or something within that range during the quarter. But definitely what we are seeing is that the origination has, you know, started to normalize as the local measures started to ease in some places. So, we would expect it to trend upwards now on. And then addressing your... your final question was related to the income?

Ernesto Gabilondo: Yes, interest expenses.

Carlos Ochoa: Yes. To the interest expense. Yes, I mean, to tell you the truth, I mean, what we definitely are going to do is the... and it is got to be more visible now with the addition of products such as the payroll and such as the consumer lending with Famsa. That the leasing product and the SMEs product altogether is not going to continue to gain weight within the book. So, as for the interest expense line, you know including the depreciation, I would expect it to remain rather stable due to these factors that I mentioned.

Ernesto Gabilondo: Thank you, Angel. Thank you, Carlos.

Carlos Ochoa: Thank you, Ernesto.

Angel Romanos: Thank you.

Operator: We will take our next question from Nicolas Riva of Bank of America.

Nicolas Riva: Yes, thanks very much for taking my questions. The first one is a follow-up question on Ernesto's previous question about this alliance with Grupo Famsa. Are you going to assume any existing liabilities of Grupo Famsa in the financial business? Because as you know, we know... as you said, we know all the problems that they have in the banking business, their banking business was revolved by the regulator. And then also, did I.. I mean, I assume you are going to take the credit risk in this business, right, in the financial business of Grupo Famsa, I am not sure if I misunderstood that you would not be taking credit risk in this. And, also in terms of size, am I looking at this correctly? Is this basically going to be as big as your existing Payroll business in Mexico? Because you said in the press release, you expect to originate 3.5 billion pesos in loans every year. And that is basically, I mean, you originated 900 million pesos in payroll loans in Mexico in the first quarter so... in the second quarter, so this is basically as big as your entire existing Payroll business in Mexico. And also, if you can tell us how much of this business will be payroll loans and how much would be white goods or durable goods. And if you have you seen a difference in terms of the NPLs for the existing business right now? If you are assuming that the business in NPLs between payroll loans and white goods for Grupo Famsa's financial business. So that is my first question. Second question, in the press release... in the earnings call, so this is not related to Grupo Famsa...

Carlos Ochoa: Nicolas, before I forget the first question, could I address it? And then we'll look into the second one?

Nicolas Riva: Yeah, yeah. Sorry.

Carlos Ochoa: Basically, the attractive part about the Famsa alliance is the potential that we are seeing specifically in the Payroll business is enormous. I mean, we definitely believe that we could be originating something in the range of 200 million or 300 million pesos or something like that, per month, which, as you mentioned, could be twice as big as whatever we are originating at this point. So that is the attractive part. On top of that, it is a business that we are very solid, that we are definitely an outlier in the industry and that we know very well. So that is also encouraging for the business on. When it comes to... so basically, the idea that we are having, and they are still, clearly this is still a work in progress, but the idea that we have is that on the one hand for the Payroll business, we should be treating Famsa as just another distributor, just as all the distributors we work with currently. So basically, that should be what we will be doing, right? So, in terms of... if you want to think in terms of risk or whatever, that should not change exposure, just going to potentiate the growth rates for the Payroll business here in Mexico. When it comes to the durable goods business, what we managed to do on the talks that we are having is to have a separated, probably going to be in the form of a trust or in the form of an SPV, which we do not intend to consolidate, in order, you know, not assessing the additional risk or something that could change our risk metrics. So basically, the arrangements that we are talking with them is something to have a portfolio with a return on assets or whatever we have on that portfolio, a return on assets to determine for the following year. However, if you ask me, the… even though the commercial part, you know, of the durable goods business is also very attractive, what is more, you know, encouraging for us is the Payroll business, which we know very well. And finally, on your question and on that same... on your same questions, no, we are not taking debt from them. This is a completely separate business. We are just providing finances for the new customers and the new origination is going to be financed by us. So, now I already answered your first one. We could move to the second one.

Nicolas Riva: Yes, thanks very much for that Carlos. So, the second one, so you show, in your earnings report that your NPL ratio was unchanged quarter-on-quarter. And you say that the loans that you restructure, because of all the debt relief measures, that you kept those... performing those following regulations. Now you also said that if you were to exclude... to account for this impact in Instacredit, Central America and Europe, the ratio would be 2.3%. Can you tell us, if you reach the same thing in Mexico, so what would be the

NPL ratio as of June if you were to include also the fact that there are loans in Mexico in your NPLs?

Carlos Ochoa: No, we did not change, I mean, that is something very important about the NPL. I mean, even though the NPL ratios stood firmly at the 1.5%, and it was the same year-over-year, I would focus on the (inaudible) on the cost of risk metrics, which, you know, which increased drastically from the 2-point something to the 3 point that... I do not have... Let me tell you the exact figure. But in any case, and if you think in terms of cost of risk... if you think in terms of cost of risk the hike from the 2.5%, which we had last year to the 3.3% already considered on the one hand, the asset deterioration experienced in all our business, in the Mexican ones specifically. And on the other hand, it also involves charge-offs during the period, even though the portfolio stood at the 1.5% NPL ratio, during that same period, we charged something around 450 million pesos to 500 million pesos. Those were the kind of the charge-offs. So, basically, I would focus at this time, I would focus more on the cost of risk than on the NPL ratio per se. So, we would not expect major deterioration in Mexico because as opposed to what we were required to do in Instacredit of... in terms of freezing the assets and so on, over here, we did not double that. And basically, we are showing whatever we achieve in terms of asset performance. I am not sure if that answered your question, Nicolas.

Nicolas Riva: No, no, I see your point, Carlos. The only thing I am saying is that, even if I focus on the current of NPL as well that... rather just NPL, you reported 246% as of June, but that number is inflated because you are accounting restructuring loans as performing loans. So, if I use the 2.3% NPL ratio that you said, which is adjusting only for Central America, then I get a coverage of NPL of 160%. But I guess the missing part is that if you were to... if you were to also adjust for the restructured loans in Mexico, what would be your true NPL ratio and therefore, your true coverage NPLs? Is that more or less clear, not my question.

Carlos Ochoa: Yes. Yes, definitely. I mean, but that is exactly what we are disclosing, the 1.5% already taking into consideration whatever we... whatever all the relief programs that we took during the quarter.

Nicolas Riva: Okay. Okay. All I am saying is in the 1.5%, you are keeping all of the restructured loans as performing loans. They are not part of the NPLs.

Carlos Ochoa: Correct. Correct. Basically, the only difference between the 2 quarters, the only difference between the two quarters are the charge-offs that there were different, right? I mean during this quarter where at the, you know... as I was telling you, it is something in the range of 500 million pesos in charge-offs that helped you to keep the NPL ratio down.

Nicolas Riva: Perfect. And Carlos, my last question quickly. On cash, you mentioned... so you were very active in terms bank finance during the quarter. You mentioned that you drew down 1.4 billion pesos in credit lines from 2 banks from Santander Mexico and from Japanese bank. You also mentioned your cash collections increased in the quarter. But if I look at the cash balance, quarter-on-quarter, it went down to 1.1 billion pesos. I also see an increase in investments. What is then that you used some of the proceeds from those... from drawing down credit lines to also maybe invest on some securities to earn a return on that? Or why this cash goes down when actually you took down all of these credit lines and cash collections in group?

Carlos Ochoa: No the... I mean if you look at the... as of the first quarter 2020... as of the first quarter 2020, we went from the 2.7 billion pesos, you know, when you add the cash and equivalents and the investment in securities went from 2.7 billion pesos to this one over here, we are on the 2.2 billion pesos, or 2-point something billion almost to the 3 billion pesos. So, it did not decline. It increased. So, your question is how did we manage to increase those?

Nicolas Riva: No, no. Because I was just referring at the cash line without including investment securities. So, my question is, is the reason why because the cash line on a stand-alone basis decreased is because you used some of the proceeds from drawing down lines of credits to buy securities, basically? That was my question.

Carlos Ochoa: Yeah. It should be something like that. I mean, it should be something definitely should be something like that. But if you look at the way we manage cash in the company is by the addition of those 2, not considered on a single basis.

Nicolas Riva: Understood. Thanks very much, Carlos.

Operator: Thank you, we will take our next question from Pedro Cardoso with Banco Finantia.

Pedro Cardoso: Can you just please provide an overview of your relief program on the Instacredit segments? And just another question, why you have not applied the kind of, sort of, the relief program in other segments?

Carlos Ochoa: Look, more than a relief program over there, it was a freeze for the portfolio in terms of... for the Instacredit business altogether. So, what we believe to be a relief program, is for example, what we are doing over here in Mexico with the SMEs very visible than the case of the SMEs when we are scheduling or granting grace periods or whatever we are doing, in order to help our customers to cope with the situation. But in the case of Instacredit, what happened was a freeze of the portfolio. It was frozen given the period. So basically, the accounts did not roll over, and that is why you see that one. But it was not necessarily a relief program.

Pedro Cardoso: Ok, thank you.

Operator: We will take our next question from Uktarsh Gupta with Silverdale Capital.

Uktarsh Gupta: Hi, good morning. So, I actually wanted to congratulate you for your alliance with Grupo Famsa. My questions are also regarding to that only. So, I wanted to understand the impact on your cost of risk and debt yield, which are you going to get on this business. So how will this alliance impact the Crédito Real's number in overall? And second thing, that since you mentioned that the loans will be there...will be funded (inaudible), I assume that one is payroll loans and second is consumer goods. So, payroll loans, I am assuming that duration will be as similar as before. So what kind of duration we will see in the second type of segment? And additionally, how they may impact your asset liability management going forward? So, in nutshell, like the overall impact of this alliance on Crédito Real financial like at a broader level.

Carlos Ochoa: Look, if I understood correctly, I mean, I would say that the main effect that this will have is going to be on the growth rates and on the origination altogether. That would be kind of in short, the main effect that we expect to see from this alliance. Is it going to lead? Definitely. As we mentioned before, it is going to lead to a monthly origination that can be as high as whatever we are originating today. Now we do not expect the risk, the company's risk to change in this end. For starters, the portfolio that we intend to keep on our book, the portfolio that we intend to keep in our book is going to be the Payroll portfolio, which is a business, and as I mentioned, we are the outliers, and we are a dominant player in that business, here in Mexico. So we would not expect… so we would not expect for the risk, at least for the Payroll business altogether, to change within our book. Now if you think about...and if you think of the other part of the business, or the other part of this alliance, when it comes to the durable goods business, which is a business that we understand very well, because that is the business where this company was built on some years ago, yes, the... there is definitely a difference in this. And that is then the reason underlying for not wanting us to consolidate that portfolio. But to provide funding to, you know, we are still trying to veer out. We are still trying to define how are we going to do this one. But that part, what we are certain at this point is that… that is not going to be kept on our books. But what we are going to keep on our book is going to be the funding that we provide for that particular business of Famsa and in which we will expect to have a determined return over assets. And basically, that is how we intend to address...to address this new business for the company.

Uktarsh Gupta: Okay. Sure. Understood. So basically, on the income which you will generate on the other part of the business, that will be recorded as the other income, I guess. Not in the interest income.

Carlos Ochoa: No, yes. In this case, I mean, talking about the relationship with the new business with Famsa, definitely it is going to be on the top line. It definitely going to be both of them, It is going to be on the top line because if you...as you might know, I mean, the top line was reflected the income that we that comes from interest. And in both cases, both in the case of the Payroll as well as the funding that we provide for the commercial for the retail, it is going to be in the form of an interest. So, we would not expect the other income from operations to change or the other...or the one that is going to be affected is definitely to got to be the first one, the first line.

Urktash Gupta: Okay, sure. So, if it is a first line, then the next question, which comes in my mind that I was looking at Grupo Famsa's NPL. So it is, like, it is quite higher compared to Grupo Crédito Real. It is like Crédito Real is 1.5%. But Grupo Famsa is 12.1%. So, like all the loans, which will be originated after this...during this alliance, will it impact the NPLs anyhow in your view?

Carlos Ochoa: Yes. If you look at the consolidated NPL for Famsa, that includes a number of business that we definitely are not in. Probably the risky one is personal unsecured loans, which we definitely are not going to go into that business. And as far as I know, as far as I believe, that was the exclusive business from the bank which they already basically...which they do not own already. And we are going to focus in the 2 lines of business that we are familiar with... that we are familiar with the risk. And those are the... as I was telling you, those are the... for starters, the Payroll business and the other one is going to be different, but definitely the risk is not going to be affected. Very important to mention that the credit analysis that we do with all...as we do with all our Payroll business, the credit analysis is on our side. So, we intend to follow our same credit policies that we use today.

Uktarsh Gupta: Sure. Understood. So okay. So basically, the presentation, which I saw for the Grupo Famsa, yes, there are 2 segments. One is consumer and one is commercial. Commercial seems the least risky. And now I am getting that durable goods are analogous to the one... this commercial one, which is having very low NPLs, like 1.3% as of 2019. Okay. Okay. Understood. Okay. Yes, that is it from my side. Thank you.

Carlos Ochoa: Thank you.

Operator: Thank you. We will take our next question from Nik Dimitrov of Morgan Stanley Investment Management.

Nik Dimitrov: Hi there. I have a couple of questions. And the first one is related to a question that Nicolas Riva asked earlier. So, Carlos, I am looking at the provision expense, right? And it seems like provision expense declined by about 12% quarter-over-quarter. If you look at it, from a relative point of view, cost of risk went from 2.7% to 3.2%. I was a little bit kind of surprised, it is counterintuitive, right? Because the second quarter was supposed to be kind of the weaker quarter where we can...we have a much better view in terms of the damage from the pandemic and everything that comes with it. So how do you reconcile the decline in provision expense on a sequential basis?

Carlos Ochoa: It did not decline. I mean, if you look at how much...for starters, if you look at the provision for loan losses for the second quarter, it amounted to 543 million pesos. Right?

Nik Dimitrov: Right. Net of recovery.

Carlos Ochoa: Yeah, net of the recovery that were 140 million pesos, totaled 404 million pesos. But we... if you look at the...if you compare the second quarter to the second quarter year-over-year, that increased roughly 59%. But, however, on a sequential basis, during the first quarter, our cost of risk was already increasing. Our cost of risk, if you compare year-over-year in the provision for loan losses, increased from the 3.5% of the first quarter to the 3.7%. So, we already have an addition over there in the form of 459 million pesos. So, quarter-over-quarter, it also increased. I mean, basically, what I am trying to say is that we started provisioning ourselves in the first quarter. And basically, that is the case. So, this is some of the 2...what you are seeing is the combination of the 2 quarters, Nik.

Nik Dimitrov: Right. So all right. Okay. Okay. Do you believe that based on what you just told me that then, kind of the worst is behind us from the point of view that the spike in cost of risk, 3.7%, is, you know, kind of the peak?

Carlos Ochoa: Could you repeat that one? The 3.7%, what you get from 3.7%?

Nik Dimitrov: Do you believe that, that is going to be kind of the peak in the cost of risk from the pandemic? From now on, it is going to continue to kind of moderate or probably remain elevated, I would argue. But it is not going to go above the 3.7% level?

Carlos Ochoa: Right. Yes, I would say that what is in the past, definitely that was in the past, the peak. I mean, but it also depends on how things evolve in the next few months. I mean, for starters, I mean, I would say that one key driver, as we disclosed in the press release, how is going to perform the Instacredit assets altogether. What we have seen so far is that the collection… collection wise, in asset performance altogether, has improved dramatically from April to this day. So in the situation that we are seeing over here through there, I would say that with the work (inaudible) that there is going to be improvements over there in terms of assets performance that could help us to stabilize the cost of risk. So definitely, that is going to be a key driver for the cost of risk altogether. And that, given that it is a percentage, it is going to be affected as well, on the origination, right? And the origination of that. So I do not know, given the limited visibility that we currently have, we just kept… we just kind to... we just kind of speculate but I think that the worst, I mean, if you think about the second quarter as the worst one, given that the loss and measures in Central America for instance have started to ease in the past weeks and the situation over here in Mexico, collection wise, has remained stable, I would say that we will be seeing something in the 3.5% to 3.7%, as you mentioned, at the peak.

Nik Dimitrov: Okay. Makes sense. You mentioned Instacredit. And I remember from previous conversations, that was one area of concern, considering how vulnerable that business is. And when I look at your net income for the quarter, right? You lost a little bit of money in Mexico, which is to be expected. In the U.S., you kind of broke-even, but pretty much the entire profit came from Instacredit. And if anything, it actually increased by about 50% quarter-over-quarter, which is very kind of, again, counterintuitive, considering also the fact that asset quality base probably overstated, considering the fact that a lot of it is under some kind of a relief program. So I am just wondering, you know, how you feel about Instacredit based on the things...the facts that I just mentioned?

Carlos Ochoa: Look, I would not say...I mean, I would not say that the gains that you are seeing… that the gains that we are seeing, the net income that we are seeing coming from Central America this quarter came exclusively from provisioning. Because altogether, if you ask me how much you provisioned during the quarter or something, I mean, the provisioning was relatively stable. I mean the provisioning was relatively stable, except for April. I mean if I recall correctly, April was the lowest month of the origination due to decrease in the assets. So I would expect a major change over there. But what I would expect intuitively, it would be the Mexican business altogether, all the lines of business here in Mexico to start improving. And that is my view on that one. Probably, once that the situation in Central America normalizes and that you have a spike in the NPLs, it is definitely going to remain on something that we have experienced in the past. I mean if you think about the NPLs that we experienced in the past in Central America due to the Nicaragua situation, at the max, it was something around 7%, 7.5%, if I recall correctly. So, I would expect it to remain within those boundaries.

Nik Dimitrov: Okay. Okay. And one last question, very briefly. I was looking at your origination. And I noticed that more than 50% of the new origination is loans to SMEs. And my impression was that focus will be more on Payroll rather than SMEs. What is it that you are seeing in SMEs right now versus Payroll? Or is it just easier to... or the demand is more on the SME side versus Payroll?

Carlos Ochoa: No, it was...yes, it was a combination of both, but I would say that the main explanation for the spike in the origination for the SME business came from short, in terms of duration, short leased loans, in particular, from factoring. So if you think about the factoring, with the duration on the average, something around 45 to 90 days, that is when you get the...that spike in the origination. What we are saying to customers that we are dealing with in the SMEs business, what they have is that they...most of them, they are recurring customers. And specifically, when you come to the factoring, yes, as you can imagine, those are mostly...those behave pretty much like revolving lines or something like that, but that is the explanation for such a high origination in the SME business.

Nik Dimitrov: Ok, got it. Thank you.

Carlos Ochoa: Thank you, Nik. Take care.

Operator: Thank you. We will take our next question from Gilberto Garcia with Barclays.

Gilberto García: Hi, good afternoon, thank you for the call… I have a question regarding your consolidation of the leasing subsidiary. Can you tell us why you decided to acquire the majority stake at this point and what were the terms for that transaction? And regarding Famsa, I just wanted to confirm that you mentioned that you intend to have a similar cost of risk relative to your current operations. So, in Payroll, will you only lend to government employees? And on durable goods, if you will not keep the loans on your book, just financing to Famsa directly, am I understanding that correctly? Thank you.

Angel Romanos: Hello, Gilberto. This is Angel. Regarding your first question, we had a pre-arrangement with our partners on the leasing business where we would buy at the beginning of this year, it would go up from 49% to 76%, which we own today. And we have an option to go all the way up to 100% in the next 3 to 4 years, and we plan to exercise that, too, when time comes. The way we acquired was in a pre-arranged formula based on net income at a multiple at which the Crédito Real stock price rates, which is very low today. And that is about your question from the leasing company. Going back to the Famsa business. On the payroll loans, we will present, as we do today with all the other loans. And we will have a very similar return, maybe a little bit larger. Because they use a larger interest rate than we use today on an average basis. So, we expect our total ROA rate to remain the same or grow a little bit in the Famsa business as it grows in our portfolio and in our books. And on the consumer side, we are using an SPV or something in the middle, where we have a trust who will receive the payments. And from there, we will do the distributions. But we are looking to have a specific return pre-arranged with them. And the rest of what they can get from the commercial and financial business will go to them. So, we will look to a fixed ROA that is convenient to us after our expenses and our cost of funds. And the rest will go to them. So, we are also kind of distributing net income with them as we do in the Payroll business. I do not know if that answers your questions.

Gilberto García: Yes. But just on the Payroll, will your target market be exclusively government employees as it is now?

Angel Romanos: We are only interested in the government payroll business of Famsa, not on the private payroll.

Gilberto García: Ok, very clear. Thank you.

Angel Romanos: Thank you.

Operator: Thank you. We will take our next question from Natalia Corfield with JP Morgan.

Natalia Corfield: Hi, thank you for taking my question. I got a little bit late to the call, so apologies if I am repeating something that was already asked. So, a couple of questions here. First of all, in terms of renegotiations, how much do the renegotiations represented of your total portfolio as of June? And also, I am interested in knowing if the renegotiations are still going on. And on this topic also, when are the loans that were renegotiated supposed to start to go back to the regular schedule? That is my first question.

Carlos Ochoa: Hi Natalia, if you look at the...I mean, what we have done so far during the quarter in terms of relief programs of renegotiation, this is amount for roughly less than 9%. Most of this renegotiation was they invoked, and they are rescheduling or grace period or something in between. So basically, the idea behind this is, as we mentioned earlier this year is addressing the situation that each customer has on a particular basis, meaning that we are trying to find a suitable solution for each customer. And basically, that is what we are doing. How long this will last? It truly depends on the overall situation. We have limited visibility to this day. But however, we have been, it has been improving. I mean the way we measure, the way we address this whole situation is in terms of how many customers are granting or leaving payments on a monthly basis and the percentage continues to be very, very high. I mean, it can be something roughly 90% of the customer base made some form of payment, either complete installments or partial installments, but what matters the most for us in these situations, then that extends for all our lines of business, is you know, to know in the form of a payment, where the customer is and we are convinced that,

that limits... that helps those in terms of asset performance as that limits our exposure with these customers. So basically, that is what we are doing.

Natalia Corfield: Okay. And this 9% that you mentioned, this does not include the IMSS?

Carlos Ochoa: Yes, it does.

Natalia Corfield: Is that include the IMSS?

Carlos Ochoa: Include? No, no, sorry. It does not include the IMSS. It does not include the IMSS. And the reason for not including that one… the reason for not including the IMSS. Is because at the end of the day, we receive the payment. I mean, we receive the net payments and the way it was booked is that we receive the payment and we granted the new loan at the end of their standing loan that the customer has. So basically, that is how we work.

Natalia Corfield: Okay. And just to be sure that I understood what you said. So, in terms of the renegotiations, you still are getting some sort of payments there. And there is not necessarily a time when you are going to stop the renegotiation. This will be an ongoing process. Is that correct?

Carlos Ochoa: It is hard to say at this point. I mean, it will also depend on how situation evolves. I mean, because what we definitely know, what we are well aware of is that we cannot... I mean, we have to be emphatic about the situation of the customer. If we force the situation, asking for payments, for example, in the case of coffee shops or gyms or whatever, I mean the success rate that we will get from doing so, it would be very limited. So I mean, we have to be flexible in that regard. And it is going to depend mostly on how the whole situation evolves in the different places where we operate.

Natalia Corfield: Okay. And lastly, on collections. If we look at collections for the quarter, if you look at the number that you were expecting to get and the number that you got overall, how much were the collections down?

Carlos Ochoa: Look, altogether, in short, we were greatly surprised on the collection front at the end of the quarter, especially if you consider the dynamics of the operations here in Mexico, we were greatly surprised. The payroll business altogether proved to be very resilient. And basically, we collected, as you can see from the report, the amount that we regularly collect on a quarterly basis. So that was a good surprise altogether. The businesses outside Mexico, for example, in the case of Instacredit, we definitely see an improvement and then this is similar in the case of the businesses in the United States, we definitely saw an improvement in the collection for the.. you know, during May and June altogether. So together that was (inaudible). I mean the only, collection-wise, probably, where were down on the SMEs front, as you can see, we were down on that. And roughly the amount, yes, I probably just exclusively for the SME, probably we would have... we collected, I do not know, roughly something around 10% less of what we usually collect.

Natalia Corfield: This including the SMEs as well or not?

Carlos Ochoa: Yes, exclusively speaking about the SMEs.

Natalia Corfield: Okay. And do you have like for instance the breakdown, how much it was down in April and how much it was down in June?

Carlos Ochoa: Yes. I mean, basically, the way we see it in terms of collection effectiveness and the trends that we saw, for example for all our lines of business, as for April was talking roughly about the 89% of the expected collection, that I think was the worst month. The 89%, roughly the 89% of the total collections that we expected is what we refer. So if you...if you go...

if you think as of June, as of June that, that amount went up at 92% in June. So, it was an improvement from April to June.

Natalia Corfield: Ok, thank you, Carlos.

Carlos Ochoa: You are welcome, Natalia.

Angel Romanos: Thank you, Natalia

Operator: Thank you. We will take our next question from Carlos Rivera with DoubleLine.

Carlos Rivera: Hi. I have a question on asset quality, especially on the payroll loan. I mean, the NPL ratio is low, but it deteriorated quarter-over-quarter. I am just wondering what is driving that. I know the pandemic is happening, but given the automatic collection, if you can provide a little bit of color there. And also, you mentioned several charge-offs. I guess those were mostly concentrated in Instacredit, if you can confirm that or there were also some charge-offs related to payroll loans in Mexico? And I have a second question after. Thank you.

Carlos Ochoa: Yes. Basically, the start that we see in terms of NPLs for the Payroll business came from our business in Honduras where we did not... I mean, which we have the...I mean, the exposure that we have in terms of Payroll business in Honduras amounts roughly something around the 2% to 3% of the portfolios over there. And we did not receive payments during the quarter. So that explains the spike from the...from the 1.5% in the Payroll for the first quarter to the 1.8% that you see. That is explained that exclusively, almost exclusively by the Payroll business in Honduras. And for the charge-offs. I mean, the charges were stable and were in the... in all the different lines of business. I mean as we mentioned, some of them came from the SMEs. But mostly, it was all across the board.

Angel Romanos: If I can fill, Carlos, on what Carlos just explained. On Honduras, it was a government measure to stop payments from government agencies for the quarter. We are supposed to start getting paid in June. And I believe that the 15th of June, we already got some payments, and we should be starting to collect. But it was a government measure to aid people through COVID-19 problem. But we do not see it becoming bigger or larger.

Carlos Rivera: Okay. A follow-up on that. So then, I would guess that payroll loan in Mexico, basically stable. And then my question will be on the Instacredit, the NPL. It improved a lot quarter-over-quarter. I was thinking it was mostly charge-offs. But now, was there anything that was reclassified from non-performing to just taken out of the NPL because of the relief programs? Was that driving the 4.7% decline to 1.3%?

Carlos Ochoa: Yes. It is a combination of both. Yes, definitely the combination of both charge-offs as well as the increase the portfolio.

Carlos Rivera: Okay. And payroll loans in Mexico and that NPL basically stable?

Carlos Ochoa: Yes, that is correct because it was embedded in this situation that we stressed for the Honduras situation.

Carlos Rivera: Okay. All right. Great. And now I would like to ask a few questions about the Famsa partnership. I would imagine this is...the origination is not an exclusive agreement given the amounts that are there. What are the conditions like, to make this a long-term profitable business for you? Because I mean, I imagine in the future, there could be more competition to finance this portfolio and dilute that with ROE that you were able to lock in. And related to that also, is there any restriction in terms of how much you can originate in terms of payroll loan versus durable goods? Or you are entirely able to pick and choose? And I would guess this...the impact of this in the overall Crédito Real in terms of funding, you are comfortable with that increase in funding requirements, especially for this year? And does that have any impact on your long-term plan for diversification? I think before, you were talking about 50% in Mexico, 50% outside of

Mexico. But probably that should change given that payroll loan in Mexico is a more attractive business. I do not know what you can comment on these points. Thanks.

Angel Romanos: Carlos, I will answer the first part of your question as for Famsa. We try to work on an exclusive basis with all of our payroll distributors. This was a deal we closed really last night. And we have been working with this for a few weeks, and we got to an agreement last night. And we believe we will be Famsa's financial arm in the near future. And we do believe this portfolio will be very significant for the overall Crédito Real portfolio. And as we said on the press release, we expect at this very beginning, to at least originate 3.2 billion pesos of new loans due to the Famsa agreement. And for the second part of your question, I will let Carlos answer it, for you.

Carlos Ochoa: Yes. Definitely, I mean, our long-term view of the...our long-term view...of the composition of our portfolio in the long-term is clearly going to be affected by the potential of this business. Hard to see by how much. And also, it is hard to see at this point, you know? Given the limited visibility that we have on the growth rates for the other lines of business, in particular, those outside Mexico. So our long-term view, what I am trying to say is that, our long-term view was clearly before all these crisis and what clearly before the Famsa deal was even on the table, so hard to say how is that going to affect. But in any case, what we are certain is that we might be compensating at the end of the..that by at least for this year, we might compensate in this second half of the year whatever we lost in terms of origination, just with these deals. So that is, I mean, we are optimistic in that regard.

Carlos Rivera: Okay. But would it be fair to say, you see this as a good origination, good quality, you would not mind to deviate from your original target and be… and remain more concentrated in payroll loans in Mexico, if the profitability is there?

Carlos Ochoa: We would not mind. We would not mind. Definitely, I mean, definitely, if you look at the business altogether, if you look at the consolidated portfolio, especially during the crisis, I mean, the resiliency of the Payroll business has shown so far, it is definitely something to... it is definitely one of the strengths that the company has. So, we will continue to grow in that line of business, expanding our penetration in different markets or in different segments of that Payroll business here in Mexico is definitely going to be positive altogether for the company.

Carlos Rivera: Okay. And just to clarify because I did not hear the answer to this part. If you wanted to originate everything, payroll loan and very little or no durable goods, is there any restriction in terms of the mix given by this contract or you can do whatever you want?

Carlos Ochoa: I mean, as Angel mentioned, it is still work in progress. I mean, those definitions specifically, I mean it has to be something suitable for the 2 parties. And we are convinced that we are going to, you know, find a profitable solution for both parties. I mean, we are very...we are… as I mentioned, we are very optimistic about this.

Carlos Rivera: Ok, great. Thank you very much, Angel and Carlos for the answers.

Operator: Thank you. We will take our next question from Nik Dimitrov with Morgan Stanley Investment Management.

Nik Dimitrov: Just a very quick follow-up. And honestly, I thought it was a question that my equity colleagues are going to ask. But I remember in the first quarter call, you said that you have not made up your mind about dividends for the fiscal year 2019, and you are going to make that decision at the end of the first half of 2020. I was wondering whether you have made up your mind whether you are going to pay dividends out? And, also I remember you put the share buyback program on hold, but it seems like you have been buying some shares back in the open market. I was wondering and whether we are going to see more of that as well. Thank you.

Carlos Ochoa: When it comes to the payout, I mean, even though the decision was already made, meaning that the pay out, the 0.75 cents per share payout was already approved by the Board and ratified by the shareholders meeting at the beginning of the year, I think the decision that still remains to be made is when is that going to happen, if that happens. I mean we... still clearly, we are not in a position to answer at this point because it is going to depend on so many factors, but that is why that decision of the dividend payout is still on hold. And as long as the, as for the other one, when it comes to the buyback, I mean, if you look at how much we bought, we are at roughly 2 million or 2.5 billion , but if you think how cheap the stock is trading we did not compromised many resources into it. So, it was roughly, I do not know, it was roughly 2 million dollars or something like that, what we bought back. And we believed at the time that it was worth... it was worth the...it was worth trying to give the stock price a support at the time and not affecting the liquidity altogether. And that is where we are standing at this point.

Nik Dimitrov: Ok, right. Thank you.

Carlos Ochoa: Thank you, Nik.

Operator: Thank you. With no further questions in queue, this will conclude our question-and-answer session. Thank you all for being on today's conference call. You may now disconnect.

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