2Q21 Earnings Call Transcript

Thursday 29th, 2021

10:00 AM CT

Operator: Good morning and welcome everyone to Crédito Real's second quarter 2021 earnings conference call. Crédito Real issued its quarterly report on Wednesday July 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. Carlos Ochoa, CEO, and Ms. Renata González, IRO. They will discuss on the more important strategic, financial and operating aspects of the second quarter 2021. I will now turn to call over to Mr. Ochoa.

Carlos Ochoa: Good morning everyone and thank you for joining us today. During our last call, my first quarterly call as CEO of the company I conveyed two principal commitments. Firstly, that we would consolidate operating and financial stability in the core elements of our business and secondly, that we would continue taking firm steps to proactively manage risk, particularly in the non-fundamental aspects of our business. We stated that these measures coupled with the improved macroeconomic prospects would allow us to preserve our asset quality in the short term and to capitalize on the surging demand in the medium term. I am pleased to report that over the last quarter our key indicators reflect that effort, resulting in a healthier and stronger position for Crédito Real. We are not yet where we want to be, more needs to be done that is for sure but all the relevant indicators point towards evolution in the right direction. Net income surged sequentially and annually to reach almost 200 million pesos, a major improvement from 1Q21 where net income totaled 89 million pesos. Year-on-year, this figure represents almost 50% growth in terms of profitability. Coupled with the system-wide recovery, this is thanks to our decision to refocus our capitalization on more resilient portfolios and better risk adjusted returns. Despite the initial industry-wide shock, we have been able to make great progress in reassuring our investor base. The renewed vote of confidence to our differentiated strategy with a much clearer focus on payroll loans and the renewed emphasis on transparency is showing across the board from bond to stock prices. It is a clear sign that we need to continue to deepen these efforts. In addition, I would like to highlight some figures that show the strength in our financial position. During the last quarter, we renewed credit facilities valued over 5 billion pesos. Our refinancing capabilities coupled with over 150 million dollars in cash, provides us with a strong footing to continue capitalizing on the incremental demand for loans as well as to meet prevailing and emerging challenges. It is important to emphasize that as we committed to, since the last quarter, we have not acquired new debt, in fact our indebtedness lowered to a factor of 3.2 times, coming from a factor of 3.3 times in the 1Q21, and well below our safety threshold of 3.5 times. Another positive indicator is our recollection level, this quarter's collections have reached pre-pandemic levels well above the 8 billion pesos mark, a record high collection for pandemic times. In this line, higher collections have enabled the NPL ratio to decrease slightly to 3.8% in

2Q21 from the 3.9% in 1Q21. Going forward, our board has recently approved the sale of a portion of the SMEs portfolio, this will support our bond buyback strategy. The sale will not only enable a more disciplined focus on our core businesses, but will also advance proactive risk management strategies. As we previously communicated, a significant portion of the original rise in the NPL ratio is attributable to a large loan incorporated into our SMEs portfolio. Payroll collection has been remarkably stable during the pandemic... (technical difficulties). But going back to where we left on the collection side, I was telling that another positive indicator is our collection level, this quarter's collections have reached pre-pandemic levels well above the 8 million pesos mark, a record high collection for pandemic times. In this line, higher collections have enabled the NPL ratio to decrease slightly to 3.8% in 2Q21 from the 3.9% in the 1Q21. Going forward, our board has recently approved the sale of a portion of the SMEs portfolio and this will support our bond buyback strategy, the sale will not only enable a more disciplined focus on our core businesses, but will also advance proactive risk management strategy. As we previously communicated a significant portion of the original rise in the NPL ratio is attributable to a large loan incorporated into our SMEs portfolio. Payroll collection has been remarkably stable during the pandemic as all the government agencies are up to date with their payments. Any concerns about alleged delays in payments from municipal and state governments, unfortunately, disregard that. Unlike some of our peers and competitors, our payroll lending is centered around the employees of federal government agencies who are AAA rated based on their likeness to pay, and those resources are mostly under management of the National Treasury, "TESOFE" for their word in Spanish, which has proven to be highly reliable. Relatably, as part of our strategy to consolidate the best performing segments of our business, Payroll lending experienced important growth, generating 1.5 billion pesos in originations in this quarter, thanks in part to the increasing contribution of our commercial partnership with Grupo Famsa. With respect to the other business segments, we made the strategic decision to decrease the size of our SMEs business within our entire portfolio. In the same direction, our SMEs portfolio is becoming more diversified, the concentration share of our top 10 loans has decreased from the 17.4% to 16.3% quarter-over-quarter. As a result of our decision to decrease the size of our SMEs business, we focused on existing customers in the SMEs Mexico segment. However, given the strength of the U. S. economic recovery, our SMEs USA segment experienced a significant rebound in origination. Used Cars continues to benefit from a strong demand and Instacredit continues to see a positive trend in the origination all aboard. Overall, we have achieved a double-digit annual growth rate about 15% within our total portfolio while taking a more conservative origination approach. Before I hand it over to Renata who will provide greater details on the developments I have just mentioned, I also wanted to highlight our inclusion for the second consecutive year in the Standard & Poor's Bolsa Mexicana Total Mexico ESG index, representing a very positive milestone for the company as it implies the recognition of Crédito Real's leadership on environmental, social and governance practices. Crédito Real is the only Mexican non-banking financial institution included in this index reflecting the profound differentiation of Crédito Real as a company that does not only comply with significantly stricter laws and regulations as a listed company in the Mexican stock exchange but is recognized as a benchmark among all Mexican business sectors for its ESG contribution by leading global institutions. In sum, throughout the last quarter, the underlying business structure of the company has remained strong and is further supported by the initial economic recovery in Mexico. Additionally, we have taken concrete steps to mitigate risk in the non-foundational aspects of our business, moreover the proactive mitigation of this risk has allowed us to prioritize the quality of the portfolio over the quantity of the loans, further strengthening our unique value proposition to investors from that of our peers in the long term. We are aware that the positives achieved in our indicators and that successful milestone we have recently achieved, do not mean that the challenges for the company have disappeared. However, we are confident that our long term the strategy focused on high quality and diversified revenues puts us in the right path to overcome these obstacles. With this, I conclude my remarks and I hand the call over to Renata. Please go ahead, Renata.

Renata González: Thank you Carlos, good morning everyone and sorry again for the technical issues. Before starting with my remarks on the P&L, it is relevant to note that this quarter marks twelve months after the consolidation of Crédito Real Arrendamiento into our financial statements, meaning that the figures from this period onwards are directly comparable and do not require any pro-forma analysis. As of quarter-end, interest income reached 2.7 billion pesos, compared to 2.4 billion pesos recorded in the same period last year, increasing 14%. This variation was driven by the operational recovery at all business segments, with Payroll and Used Cars being the top performers. The decrease quarter-over-quarter is explained by a foreign exchange gain experienced during the first quarter 2021. The declining weight of loans under relief programs on the company's portfolio also contributed to this result, standing below the 1.0% as of the end of this quarter against 8.6% in the same period last year, and are expected to completely come-off over the second half of the year. It is important to remember that interest income also includes income from factoring activities that has a relatively low weight on the consolidated revenue. Consequently, total income rose 10% year-over-year, amounting to 3.0 billion pesos. During the quarter, interest expense totaled 1.4 billion pesos, increasing almost 22% when compared to the 1.2 billion pesos recorded in the same period last year, mainly reflecting the higher indebtedness that the Company has incurred over the last twelve months, which has been oriented to portfolio growth and enhancement of the liquidity profile. Consequently, the financial margin amounted to 1.3 billion pesos, an annual increase of 7.4%, resulting from the improved loan portfolio mix that entails better-performing assets under the challenging environment, more than offsetting the negative carry associated to the undeployed proceeds from the Senior Notes 2028. Net provision for loan losses was 320 million pesos, down 21% year-over-year, which implies a cost of risk of 2.4% during the quarter. In this regard, the coverage ratio closed at 122.5% mainly derived from the bullet loan in the SMEs segment. Meanwhile, quarterly administrative and promotion expenses totaled 932 million pesos, increasing almost 19% year-over-year, in line with the recovery and growth seen at overall origination and collection. In the bottom line, net income amounted to 193 million pesos, compared to 131 million recorded in 2Q20, representing a 47% growth year-over-year. On a sequential basis, net income increased a 116%. This variation is a clear sign that the adopted strategy to reallocate resources and strengthen the company's capital structure was the right call. Return on average equity was 4.5% as of quarter-end, compared to 2.8% in the same period last year; and, return on average assets expanded 30 basis points against last year, standing at 1.0%. Capitalization ratio was 31.7% in the 2Q21, 2.7 percentage points below the 34.4% recorded last year. The funding cost recorded a 110 basis points increase, from 9.1% at the second quarter of 2020 to 10.2% as of June 30, 2021, primarily due to the negative carry related to the Senior Notes 2028 undeployed resources but dropped 100 basis points on a sequential basis following the improvements attained at our debt profile. It is worth noting that our efforts oriented to secure sources of funding at better conditions have gained further importance before the probability of an arising backdrop of a less accommodative stance that seeks to face inflationary pressures. In this sense, the Mexican central bank “Banxico” already decided to hike the reference rate in June and a similar posture prevails in the United States, but the European Central Bank has decided to hold the rates unchanged. Breaking down loans’ portfolios by business segment, the consolidated loan portfolio amounted to 55 billion pesos, up almost 7% compared to the last year, largely attributed by the outstanding performance in Payroll and Used Cars. Consolidated non-performing loan ratio rose to 3.8% in second quarter 2021 from 1.5% past year, as this metric was impacted by a client in the SMEs segment. On a sequential basis, this metric showed an improvement of 10 basis points. Payroll loan portfolio grew 11.0% year-over-year, reaching 32 billion pesos, driven by an enhanced outreach and a stronger competitive position in northern Mexico, thanks to our alliance with Grupo Famsa, with delinquency remaining below the 2.0% mark, at 1.8%, result of our successful endeavors in profiling of clients. SMEs portfolio totaled 12.4 billion pesos, an annual contraction of 2%. As Carlos mentioned, this decline mainly follows our strategy to reduce our exposure in SMEs, particularly in Mexico, to around 15% of the total loan portfolio, from a weight of 22%, and our origination focus on payroll and other less-capital intensive products that render considerably lower default risks. As was the case last quarter, the non-performing loan ratio increased due the recognition of the SMEs individual loan going up from 0.4% in 2Q20 to 11.6% this period. Meanwhile, Used Cars portfolio expanded 7.0% when compared to the second quarter 2020, amounting to 4.3 billion pesos. This growth was mainly fueled by the strong demand for used cars in both Mexico and the United States. Delinquency in this segment continued to improve, standing at 1.2%, in line with the adoption of stricter origination and collection standards. Lastly, Instacredit’s loan portfolio contracted as of quarter-end, to 5 billion pesos, and this segment's non-performing loan ratio closed at 4.8%. Turning to the balance sheet, as of June 30, 2021, total assets increased 2% compared to the same period 2020, amounting to 76.2 billion pesos, attributed to the consolidated portfolio growth, a larger debt incurred and arrangement of hedging instruments over the last twelve months. As of quarter-end, the company's outstanding debt totaled 56 billion pesos, up almost 6%, mostly explained by the placement of our Senior Notes 2028 and a higher bank debt. Nevertheless, compared to the last quarter, total debt decreased 1.3%, improving the company's leverage to a debt-to-equity ratio of 3.2 times. To conclude, stockholders' equity totaled 17.5 billion pesos, an annual decrease of 1.9%. 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: Ladies and gentlemen to ask a question please press *1 on your telephone keypad, if you are using a speakerphone, please make sure that your mute function is turned off to allow your signal to reach our equipment. Once again that is *1 to ask a question, please hold while we hold for questions. Your first question for today is coming from Nicolas Riva, please announce your affiliation then pose your question.

Nicolas Riva: Thanks, this is Nicolas with Bank of America, thanks Carlos and Renata for the chance to ask questions. I have two questions and then I am going to have another question on a different topic. So first, on originations and specifically wanted to ask you about your strategy because in every earnings call, I mean for the last few quarters, you have been saying that the idea is to decrease your exposure to SMEs lending and to focus a lot more on payroll. If I look at origination in this quarter, you originated even more in SMEs than in payroll, you originated 1.7 billion pesos in SMEs, one and a half billion pesos in payroll. So I wanted to ask you how those origination figures are consistent with your strategy? And then my second question on this other loan segment, which is only just over 2% of the loan portfolio but in this quarter this was the segment where you originated the highest amount of any segment, you originated 2.2 billion pesos in this other loan segment, and I wanted to ask you, are you including here the payroll loans to the Famsa clients or are those included in the payroll segment? Thanks.

Renata González: Yes, hi Nicolas thank you for your questions. First of all, the origination increase that you are seeing on the SMEs it comes from the business in the United States. Well, you can see that basically we have an 86% increase on the origination on the first half of the year. If you compare the SMEs in Mexico, you can see that we have been experiencing a drop on the origination of about 50% quarter-over-quarter and above the 70% year-over-year, and that is the rationale and the strategy that the company has at this moment, to reduce the exposure on the SMEs in Mexico. Regarding the second question on the other, we include in these lines a part of the alliance that we have with Grupo Famsa that is funding the durable goods segment, if you see the disclose that we have on this portfolio, around the 65% of others corresponds to the durable goods segment from Grupo Famsa. When it comes to the alliance that we have on the payroll segment, you can see that it is recognized under the payroll segment.

Nicolas Rivas: Okay, thanks for those answers Renata. So, on the first point then, when you are saying that you want to decrease exposure to SMEs lending you are specifically referring to the Mexico business and given your strong origination figures in the US, we might continue to see strong origination overall from the SMEs lending book.

Carlos Ochoa: That is correct Nicolas, that is correct. We are... what we are perceiving are, you know, in terms of... in economic terms we are perceiving totally different, you know, the performance in the two books, so the one that we intend to unwind is the Mexican one.

Nicolas Riva: Okay, understood. And then on the second question that Renata had responded. So then regarding the Famsa JV, the loans to finance the acquisition of durable goods those are in other loans, payroll would be in the payroll segment, which... I thought that the acquisition of durable goods was the business that you kind of did not want so much in that JV, but it came along as a legacy business. But then, you know, the fact that you are originating so much in these other loans, the 2.2 billion pesos at least to me is surprising.

Carlos Ochoa: No, no, if you look at what we are originating in Famsa is less than 100 million pesos per month. You know, it has to do something with the duration of those facilities but in any case, the attractive part of it is that, you know, as part of the agreement with them is that what we expect is a return on assets for that particular portfolio of 8% so in any case we feel very comfortable with that.

Nicolas Riva: Okay thanks Carlos. And then on Radiopolis, can you give us an update on the legal process to execute on the collateral? And If you are still 45% provision on that 700 million pesos loan and you know, given where we are in the third quarter now, if you expect to or need to provision more for that loan in the third quarter.

Carlos Ochoa: The next step up in provision that is going to come at the end of the year, you know, consistent with the expected losses methodology of provisioning, that is going to happen there. On how we are handling this, you know, it is hard to provide the estimates about the legal procedures, especially this year. But the reference that we have is that things are moving in the right way so what we would expect for this quarter to find a suitable solution for that particular issue.

Nicolas Riva: Okay thanks very much and the last one, when you say that the cash collections were 8.3 billion pesos I believe, just to confirm, you are including there both collections on interest and principal.

Carlos Ochoa: Yes.

Renata González: Yes, that is good.

Nicolas Riva: Thank you very much, Carlos and Renata.

Carlo Ochoa: Thank you Nicolas.

Operator: Your next question is coming from Carlos Alcaraz, please announce your affiliation then pose your question.

Carlos Alcaraz: Hello Carlos and Renata good morning, this is Carlos from Apalache Analisis. I have two questions, the first one is, towards year-end what is your estimate of the participation of payroll in the total portfolio? And the second question is, once completed the ramp-up process of Famsa, what is your estimate of its weight for the payroll portfolio? Thank you.

Renata González: Hi Carlos, what we are expecting is, if you see this quarter, the federal segment has been increasing the participation given the focus we are having on these business lines by the several initiatives that we have taken throughout the years. So, what you should be expecting is that payroll continues to gain weight above the 50% of the consolidated portfolio, given the decrease that we will be experiencing on the SMEs portfolio in Mexico.

Carlos Alcaraz: Okay, thank you very much and congratulations on the solid results.

Carlos Ochoa: Thank you.

Operator: Your next question is coming from Denis Parsian. Please announce your affiliation then pose your question.

Denis Parsian: Hi I am with Morgan Stanley, thanks for the call and the question and answer grid. I have a couple questions could you update us please on the status of the sale of the foreclosed assets? I believe earlier this year you said that you expected a to sell a fairly large chunk particularly related to some prime real estate in Guadalajara by May-June, and by once you sort turn the clock past mid-year that you would have to start thinking about impairing those, so we saw on the motions in quarter that that line in your balance sheet actually increased rather than decrease, so it would be great to get some update there and update in terms of how are you going to provision for it and when? Also, second... I will ask all the questions and you can handle them the way you like. There was a sudden decline in the NPL ratio of the others business, could you explain that please? And then thirdly, could you possibly provide us with an update of the I.M.S.S. process whereby they have announced cap rates and perhaps you could discuss the likelihood or not of that tendency to spread out to other government agencies. Thanks a lot.

Carlos Ochoa: Hi Dennis let me address the first question, you know, in terms of the foreclosed assets. I mean, definitely we see improvements in those negotiations, however I mean it has been rather slow, especially was slow because some of the people interested in buying some of those pieces, some of those assets were expecting the outcomes of the mid-term elections here in Mexico. Given that that recently past just a few weeks back, I would expect that definitely for the second half of the year, I mean we will see an improvement over there in terms of the sale of those assets. Definitely, I mean if you look at the not only the auditors but also rating agencies are well considering the, you know, they are well aware that if those assets last longer in our balance sheet, at some point, we will have to test them for impairment but not at this point so basically that is where we are standing. If you see a minor increase this quarter in the foreclosed assets, that was due because, I mean I have been very explicit about the focus on the collection and that is something that you can perceive this quarter, not only on the collection process, which as you know, at pre pandemic level of 8.4, close to 8.4 billion pesos, you know, reaching above our 8 billion mark, but also the focus, if you see also there was an improvement in terms of collections of charged-off accounts. The other end is when there was a particular case in which we felt that we would not, you know, we would not make a significant improvement, so we, you know, take another piece of land in the... (inaudible) piece of land was 70 million, for 70 million if I recall correctly, and the market value of it exceeds that amount, basically exceeds that amount. Coming to the NPL to the...

Renata González: Hi Denis can you repeat the second question you have of the other segments?

Denis Parsian: Yes the second question was, the NPLs in the other segment collapsed, can you explain?

Renata González: Yes it is basically, as I was mentioning on the other segments we basically registered the funding that we provide with the SPV on Grupo Famsa in the durable goods segment. So given that our counterpart is the SPV, we do not have any delay on the payment and that is it.

Denis Parsian: Sorry, could you repeat that please?

Carlos Ochoa: Yeah, basically, is that given that the most of... the largest portion of that book, I mean is coming from the SPV, the durable goods alliance with Famsa, that is what is bringing the NPL ratio down.

Denis Parsian: What is it about the fact that it is coming from the SPV that brings the NPL down? I am not clear on the mechanic.

Carlos Ochoa: Yeah, if you recall, I mean the original agreement that we have with Famsa is that we would not hold I mean given that we do not want to change the risk metrics in the company, what we did is that we kept an SPV up, you know, next to it so that we do not consolidate. But on the other hand, Credito Real provides the funding for that particular SPV and the expected return for them is the 8% that I mentioned just a few minutes back. So given that you know, all the funding that we are providing over there is current is basically was driving the NPL ratio in the line of orders down. I do not know if that is more clear.

Denis Parsian: So it was a change in methodology?

Carlos Ochoa: No, it is not, it is simply, the reason that we are, you know, splitting it, I mean that we are putting it on the line of others is just, you know, to clarify what we have, what exposure that we have on the durable goods segment, you know, that is coming from the, you know, from the alliance with Famsa.

Denis Parsian: Okay.

Carlos Ochoa: And coming to your final question, you know, in terms of, a risk of contagion, you know, from what is happening in the IMSS to the other government agencies. Well, I mean, it is hard to answer that, but basically, I mean, what I could refer to the experience that we have. So if you think that, I do not know, I think it was five or six years ago when the I. M. F. when the IMSS lowered rates and there was no effect on the other lines of business. However, I mean, we believe, I mean, we have been very emphatic about this is that, you know, given the other part of the great agreement with (inaudible) with the IMSS, which is to lower the commissions paid to the to the (inaudible), most of this can be upset. So at this point, I mean we have no visibility of interest rate caps and we do not foresee any contagion to other government agents.

Denis Parsian: Sorry, you cannot even say anything about the timing of when the IMSS is going to implement what it said it was going to implement. Are you calling into question you think they might not even move forward? Is that what you are saying?

Carlos Ochoa: Yeah, what I am saying is that based on our experience, I mean when they IMF 5 or 6 years ago, lowered the interest rate, that that did not have any effect on the other government agencies. So basically in short, what I am saying is that we do not foresee any contagion to other government agents.

Denis Parsian: Right, yeah I mean I guess there is two parts to my question, one was contagion and the other one was the timing of the implementation of the IMSS process, which is still material, right? It is what it was like 17% of your total book, it is still a material number.

Carlos Ochoa: You know, if you look at the origination about if you look at this year's origination, you know, the origination for the IMSS, it does not reach the 10%, I think it ranges something around the 8% or something. So what I am saying is that if at some point we stopped we would stop originating for pensioners, you know, the effect that it would have in terms of portfolio would be something around 300 million, if I recall correctly, that is about it. I mean just to just to remember you that the IMSS, I do not know probably 4 years ago, 3 or 4 years ago amounted for roughly 40% of our book and that has been coming down over the last two years and now origination-wise, it does not even reach to the 10%, not even to the 9%. So that is where we are standing.

Denis Parsian: Right, got it, thanks very much.

Carlos Ochoa: Thank you Denis.

Operator: Your next question for today is coming from Carlos Legarreta, please announce your affiliation then pose your question.

Carlos Legarreta: Hi good morning this is Carlos Legarreta from GBM thank you for taking the question. It is actually two, just on the provisions I was hoping to get some more color on the reduction by segment. And the second one, and apologizing in advance if this has been addressed, but the dividend payments, I understand this was supposed to occur during the first half, but this was delayed during late June so I just want to understand what is the timeline for that or the order of priority for the company. Thank you.

Carlos Ochoa: Yeah, I mean when it comes to provision and probably the best determination if you think in terms of the cost of risk, is basically that our collection efforts, our focus on the collection paid off during this quarter. We have recollected out of charged-off accounts, something around 80 million pesos and that is what is lowering the cost of risk to the 2.4% but this was for this quarter so that is where we are standing, I mean, in short it is basically, you know that the focus on the collections have been paying off. Now, moving to your second question about the dividends it is too soon to say, it is too soon to say, I mean basically what we are doing… what the shareholders' meeting approved was... they authorized the Board, you know, to determine when are we going to pay the 2019 dividend and we still have not decided yet. And that is going to be, you know, the key aspect on that decisions are going to come from the capitalization, are going to come from our liquidity base and that is where we are standing.

Carlos Legarreta: Thank you for the comments.

Operator: Your next question for today is coming from Joel Rosado. Please announce your affiliation then pose your questions.

Joel Rosado: Hi, I am calling from Bank Financia to thank you for taking my call. I just wanted to better understand the progress on short term on the funding, you have been renewing as far as I understand, there has been some progress since the fourth quarter of 2020 but there is still a significant amount of short-term debt, so I wanted to understand when are you planning to roll over those maturities?

Carlos Ochoa: Look, I mean at this point the company has ample liquidity to run the business and to pay out or refinance any upcoming maturity. You know, as we mentioned, you know, we have so far renewed you know facilities well over 4 or 5 billion pesos, over 5 billion pesos. You know the strong business model of the company and the significant economic recovery that we are, I mean we are seeing a major improvement in terms of the collection so that along with the support that we are getting from the banks, I would say that we are in a good position to refinance that. You know, if you think that the total that we have to refinance for this year is something around the 4 billion or something within that range and out of them, it is like, I do not know, it is probably like 70% of them are revolving lines from banks, that we have been working for a number of years, I mean, we feel confident that we will manage to do so. So right now, if you think in terms of refinancing, the focus has been in setting up the right foundation to be in a position to refinance the CHF bonds, which is due in February, that, you know, all our efforts are focused on towards that end.

Joel Rosado: Okay, and do you expect to come to the market to refinance that bond or will you do that through the bank market?

Carlos Ochoa: At this point, I mean the expectation, even though that looks further away, I mean from the positions we currently are, I believe that in the next couple of quarters we will be in a much better position, you know, to tap the market, otherwise we will rely on bank or on the cash that the company generates. So basically it is hard to predict at this point, but we do not perceive refinancing risks.

Joel Rosado: Thank you.

Carlos Ochoa: Thank you.

Operator: Your next question is coming from Artem Sumaed, please announce your affiliation then pose your question

Artem Sumaed: Yes Carlos hi how are you? I have a few follow up questions. If you do not mind, the first one will be on your origination. I mean during the first quarter you said the payroll business is most stable and you have among other segments and you have a great expertise and here, right? But we see that your origination is almost, is above 50% down quarter to quarter, especially for this segment, while other segments in well much lower in terms of origination and any of the other segments, you showed some increase right? In your origination. So my question is why do you decided to cut exactly payroll segments in terms of origination? How is it in within your strategy, right? In general-end, and what were the reasons behind this? It is related to well common regulatory environment from IMSS or something like this? So I would be grateful if you could give a bit around this, thanks.

Renata González: Hi Artem, following the strategy that the company has at this moment where we are ramping up the origination on the payroll-side, this is taking a toll on the origination overall of the company, given that when we were increasing the SMEs line you can see that we had overall higher origination level. Right now that the strategy is to continue decreasing the origination that right now stands around the 20% to 30% of what used to originate on the SMEs-side that is why, that is how we can explain this decrease in the origination. On the other side you can see that the origination is increasing mainly on the payroll side, we have experienced an increase in the origination of about 80% compared to last year, and we are also increasing our origination in other businesses such as the used cars in the United States.

Carlos Ochoa: And to complement on that one, I would say that the goal for, I do not know for this year when it comes to the SMEs is you know to unwind the book and to sell a portion of those assets and charge off when it is necessary, but the goal is going to be, you know, that the Mexican portion of the SMEs business does not exceed the 10% of the consolidated book. So that is what we are aiming and this is going to come from, you know, one of these, uh, from a combination of the things that I just mentioned, you know, either selling asset or charging off or just simply unwinding, however, the unwinding part takes much longer. And probably, you know, it is worth mentioning, that whatever we get, whatever resources we get from the sale of these assets are going to be deployed into our bond buyback program.

Artem Sumaed: Yes, sorry, but I still did not get why do you decided to cut your payroll origination especially for this huge amount in terms of about 50% quarter to quarter, you said about SMEs which it is clear but why that in the payroll business?

Carlos Ochoa: Yeah, the payroll I mean that we are seeing improvements, I mean if you look at the there is a massive improvement, you know year-over-year, there is a massive improvement in terms of the payroll origination because last year was you know, mostly affected by the lockdown, If you think that the lockdown in Mexico started exactly on that second quarter, I mean however, you know we have been able during this year, we have been able to compensate and to you know gain traction in terms of origination. When it comes from this quarter, the origination has been coming from, I do not know, the northern states which is the result of the alliance with Famsa, and that we have been more you know, increasing our penetration in the other government agencies we have worked with. I mean we provide full color of it in our earnings release.

Artem Sumaed: Okay, thank you. The next question on your announced bond buyback program, could you kindly indicate any exact parameters for this buyback? I mean which part of the curve you are targeting for the buyback? Maybe any absolute amount for the (inaudible).

Carlos Ochoa: So no, when we come I mean the answer to buying back bonds is very simple, we see an enormous opportunity you know given the price they are trading some of them especially you know the 28s and the euro, we see an enormous opportunity and (inaudible) since I became CEO, I mean the focus at least for the next few quarters is going to be on capital allocation and definitely buying back bonds where at the level they are trading, it makes all the sense in the world, so that is something that we are going to pursue and that was approved by the board, you know, on this week's meeting. And on the other hand, finally, you have the liquidity, we still have liquidity and that is basically where we are.

Artem Sumaed: Well, okay, my next follow up on your dividends. I mean, during the previous conference call for the first quarter, right? You said that you aimed to pay dividends for 2019 but dividends for 2020 upon decision of operating agencies, right? And we saw writing downgrades from both rating agencies, so my question for dividends on 2020, what is the process with them and what is the current status on dividends for the previous year?

Renata González: Artem, regarding the dividend payment if you recall we approved the dividend payment before the pandemic and then we postponed them over the last AGM that we show during this year. So basically, right now the decision is from the board of directors which are constantly monitoring the strategy and status of the company, so they will decide at which point we are going to pay 2019 dividends. Regarding the 2020 dividend payment, at this point, there has not been any decision If we are going to pay the dividends.

Carlos Ochoa: And to complement that, you know, our key focus is to preserve the financial health of the company. So that is basically it.

Artem Sumaed: Yeah, great thank you. And the last remark from my side, you made about 5 billion of pesos refinancing in this quarter, so it will be great if you could give us a bit more color in terms of this refinancing quotes, I mean what were the conditions for this new lines? So it is better, what works in terms of pricing and in terms of your future margins, so any color on that would be grateful. Thank you.

Carlos Ochoa: I am sorry Artem, could you rephrase that? Because I am not sure I got the question, sorry.

Artem Sumaed: Yeah sorry. I mean what are the terms of this refinancing you made during this quarter? It is about five billion pesos, so I would like to compare with your funding costs, so is it high, is it lower it in line with your current funding costs, right? That is my question, am I clear?

Carlos Ochoa: Yeah. Look, basically when it comes to the... I mean something that is worth mentioning at this point is, you know, 75% of our debt is fixed at this point. So when it comes to the refinancing, we are seeing, you know, rather stable condition, and we are working more, so we would not expect that to change drastically, you know, with the upcoming refinancing or with the upcoming maturity, that is where we are, but that is basically it.

Artem Sumaed: Well, okay, thank you so much.

Carlos Ochoa: Thank you Artem.

Operator: Your next question is coming from Gilberto Garcia, please announce your affiliation then pose your question.

Gilberto Garcia: Hi, good morning, this is Gil Garcia from Barclays, thank you for the call. You mentioned in your press release that all government agencies are up to date with their payments, however, we see that payroll interest income remains well below historical levels and NPLs actually decreased slightly quarter on quarter, because this means that the levels we are seeing in terms of both yield and NPL are what we should expect going forward in the new normal of this segment.

Renata González: Yes, hi Gilberto, that is correct. What we want to convey, the message that we want to convey right now is that all the government agencies that we have are up to date, if you see the payroll collection has been stable since the coronavirus situation started, so practically we have not seen any different conditions throughout the last year on the collection side. The important thing on this segment is on the origination side given that right now we are accelerating the origination and you could see this quarter that we closed the origination levels around the 1.5 billion pesos, so basically we have not experienced any change on the collection side and regarding the non-performing loan, it is a very stable non-performing loan for the payroll side given that we are below the 2.0% mark.

Gilberto Garcia: Okay thank you…sorry.

Renata González: Yes, I just want to close with the current non-performing loan is not the new normal, we are expecting that this could be lower in the next quarter. And also, the focus that we are having in this segment and by decreasing the concentration that we have on the SMEs overall, so we are expecting that on year-end, the non-performing loan should be closing in a more normalized level for Crédito Real.

Gilberto Garcia: Thank you, on SMEs intention to sell a part of this portfolio, can you comment on what size of the portfolio you would be looking to sell? Whether you have had conversations with potential buyers? Carlos, you mentioned that you might be willing to you know, take perhaps a loss on this sale, what sort of level of charge off would you be comfortable with in order to generate liquidity?

Carlos Ochoa: Look, I mean, look Gilberto, you know, probably to some result, I would expect the SMEs business in Mexico to reach something around the 10% of the book, that is what we are aiming, right? And yeah, this is going to come either from the sale of assets which we are currently, you know, we are looking for opportunities in that regard, so that is something that could be accomplished as soon as this quarter, I do not know, but the main goal is going to be on the other end you know, to reach this fraction this portion of the consolidated book. The thing about the NPLs and the thing about, you know, the other aspect, I mean one of the things is, you know, that provides us its own, you know, flexibility is the fact of having, you know, rather, you know, a large provision base, so in terms of the what I am trying to do, what I am heading with this, it is basically cutting the right provision base, provide it with flexibility in terms of pricing and in terms of charges, so I would not expect you know to affect P&L by charges off in that particular line of business, but the main aspect is to reduce drastically the concentration that we have on the SMEs business.

Gilberto Garcia: Okay, thank you. And lastly on a different subject, we understand from conversations with clients, some of them investors of yours, that they have contacted your external auditory seeking clarification about some of your financial statements, can you comment on whether you would authorize your auditors to, to engage with these investors? Thank you.

Carlos Ochoa: Look, I mean, you know, we are constantly in touch with all our investor base, you know, and the focus to solve the problems, the challenges that we faced this year has been on the transparency side, so we keep a very close touch with them and addressing all the questions that they that they might have. The most suitable answers for most of the questions reduces to, you know, a cash flow analysis, if you look at all the amount of money that we consistently collect on a quarterly basis that explain most of the concerns of whatever our investor base may have. So that is how we have been addressing, you know, all the questions based on transparency and being very clear about the cash flow analysis.

Gilberto Garcia: Okay thank you.

Operator: At this time we will take the last two questions in queue. You do have a follow up question coming from Denis Parsian, your line is live.

Denis Parsian: Sorry thanks, you have answered my follow up question, thanks.

Operator: Your next question is coming from Jonathan Swarc, please announce your affiliation then pose your question.

Jonathan Swarc: Hi, good morning Renata and Carlos from Debtwire Research. Carlos, you mentioned that the return on asset on the durable goods JV with Famsa is 8% but that is on the equity side that you provide. How does that JV get funded?

Carlos Ochoa: No, look the agreement that we have is that we are providing the fund and we are charging, If I recall correctly, we are changing an interest rate of 20% for the fund, you know, deployed to fund that particular portfolio. That at the end of the day, what we would expect is to reach for that a return on asset of 8% and whatever exceeds that amount, corresponds to our partners there. That is basically the answer.

Jonathan Swarc: Okay. And the second one and I think I am done is are you planning to buy continue buying back equities? Because you mentioned about the bond buyback program but I mean inequities you can do significantly more, which much less.

Carlos Ochoa: You know, the equities buyback program is a different story because you know what we aim, what we are aiming for is not to weaken our capitalization base but quite the opposite. The opportunity that we are seeing given the level at which our bonds are trading is you know that we are going to enhance the capitalization, so that is basically the big difference, if you look at what we have got so far this year it just amounts for roughly, I do not know if I recall correctly it should be something around 5 million dollars or 11 million shares that we have on the treasury over here, but those are the two differences. The difference and focusing, and again, focusing on capital allocation, the opportunity that we are seeing is on the side of buying back bonds.

Jonathan Swarc: Okay, thank you.

Carlos Ochoa: Thank you Jonathan. Well and with this we conclude the quarterly call, once again we are sorry for all the inconvenience and the technical difficulties that we have faced. Thank you everyone.

Renata González: Thank you everyone, goodbye.

Operator: Thank you everyone. Thank you ladies and gentlemen, this does conclude today's conference call. Thank you for being on today's conference, you may now disconnect your phone lines and have a wonderful day, thank you for your participation.