Crédito Real, S.A.B. de C.V. SOFOM, E.R. – Third Quarter 2016 Earnings, October 27, 2016

C O R P O R A T E   P A R T I C I P A N T S

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Carlos Ochoa, *Deputy Chief Executive Officer*

P R E S E N T A T I O N

Operator:

Good morning. My name is Amy and I will be your conference Operator today. At this time, I would like to welcome everyone to the Crédito Real's Third Quarter 2016 Earnings Conference Call. Crédito Real issued a quarterly report on Wednesday, October 26, 2016. If you did not receive a copy via email, please do not hesitate to contact us in Mexico City at +52 (55) 5228-9753.

Before we begin the call today, I would like to remind you that forward-looking statements made during today's conference call do not account for future economic circumstances, industry conditions and company performance and financial results. These statements are subject to a number of risks and uncertainties.

Today from Crédito Real in Mexico City, we have Mr. Angel Romanos, Chief Executive Officer and Mr. Carlos Ochoa, Deputy Chief Executive Officer. I will now turn the call over to Mr. Romanos. Please go ahead, sir.

Angel Romanos:

Thank you, Operator. Good morning everyone and thank you for joining our Third Quarter 2016 conference call. We are very pleased to announce that third quarter '16 was the best quarter in the history of Crédito Real. Including non-recurring items, the net income amounted to Ps 588 million and the loan portfolio grew almost 40% year-over-year.

2016 shall mark a breaking point in the history of Crédito Real. This year has been challenging in many different ways. Firstly, the consolidation of the acquisitions made at the beginning of the year and the learning process involved has been very demanding. Secondly, we started this year with a need to refinance almost 40% of our outstanding liabilities, most of which were due during the first quarter. Furthermore, an extremely volatile economic landscape and unanticipated political scenarios forced us to plan in terms of where we foresee the Company's growth in the coming years and not only in the short term. Lastly, the communication efforts made throughout the year to reassure all the stakeholders of the Company has been very rewarding.

It has been over a year since we decided to extend our geographical and products footprint. Once again, we have proved that our business model continues to deliver remarkable results. Currently, 10% of our loan portfolio and total origination comes from our businesses in the United States. Our Don Carro acquisition and operation exceeded our estimates during the quarter and we are convinced that this partnership is the best way to reach our Latin American customers in the US. As such, we are building strong foundations for growth. Regarding Instacredit, almost 20% of new credits originated in Crédito

Real came from Instacredit. Moreover, with our international expansion, one third of the interest income of Crédito Real is generated through stable currencies.

During July we issued a $625 million Senior Notes due in 2023 with a 7.25% semi-annual coupon. With the proceeds of such issuance, we purchased nearly 70% of the total outstanding amount of the 2019 notes. Together these two transactions were the largest liability management program done in the history of Crédito Real. As of this quarter, we have extended the debt profile from two years in 2015 to four years today.

Regarding the extremely volatile economic landscape, we do not have any FX exposure, since all our dollar denominated debt has a full cross currency swap or is naturally hedged by our assets in US dollars. In terms of the interest rate increase that we are facing, we are able to mitigate the effect by adding high yield products outside of Mexico.

Our payroll loan portfolio grew by 14% with a healthy 2.4% NPL ratio. As previously disclosed, we do not foresee any material adverse effect in the near term in the asset quality, origination or performance of our loan portfolio due to the demonstrations against the Mexican educational reform. Our exposure prevails unaffected to CNTE in Oaxaca, Guerrero, Chiapas and Michoacán states. We continue doing significant diversification efforts, one of them being the pensioners market which represents 25% of payroll origination and 17% of the portfolio for the quarter. We will continue with our origination procedures, diversification attempts and enlargement of our presence within federal entities to continue developing a healthy payroll loan portfolio.

In the 2016 guidance we disclosed earnings growth in the range of 15% to 20% with return on equity around 20%. Year-to-date September figures reaffirm our guidance with a 16% earnings growth and a 20% ROE. We have consistently built a strong credit platform that today serves 770,000 customers, 39% more than a year ago.

Finally, in spite of the fact that both our outstanding bonds have been performing remarkably well in the debt capital markets, this positive trend has not yet been reflected in our stock price. We see this as an opportunity. As such, given the current valuation of Crédito Real´s shares, the Board of Directors has taken the decision to implement a share buyback program for as much as $20 million. Nonetheless, the largest opportunity continues to be fulfilling the need for high quality financial services for the segments of the population that are traditionally underserved which remains at the core of our business."

With this, I want to thank you again and leave you with Carlos Ochoa..

Carlos Ochoa:

Thank you Angel. Good morning and thank you all for taking part in our quarterly conference call. During the quarter we had the effect of a non-recurring item registered on the unwinding of certain financial derivatives and transactions. The change in the hedging and strategy that led to such unwinding is attributable to the successful tender offer for the Company's 2019 Senior Notes. The effect of this non-recurring item was an additional interest income of Ps 293 million and Ps 211 million in the net income. Also, during the quarter, we experienced a negative carry which is originated by the remaining unused resources of the Senior Notes 2023. The effect is reflected on investment and security on the balance sheet that accounts for Ps 3.2 billion and on the P&L for an additional interest expense of Ps 66 million.

Regarding the interest income, during this quarter we reached interest income of Ps 1.8 billion, increasing 67% on a recurring basis compared to the third quarter of '15. Instacredit contributed to 27% of consolidated interest income including the gains from unwinding the cross currency swap interest income increase by 93%. Nowadays, one-third of the interest income from Crédito Real is supporting denominated currencies.

Concerning the funding, the average funding costs increased from 6.4% reported on the third quarter ’15 to 9.6% here in third quarter ’16. Instacredit only add 120 basis points to the consolidated and also the negative carry amounts were 60 basis points. Excluding the Instacredit consolidation interest expenses and the mentioned negative carry, Crédito Real’s cost of funds would have reached 7.7%.

When it comes to the financial margin, the financial margin increased by 46% on a recurrent base to Ps 1.26 billion driven by interest income growth. Instacredit contributed to 30% of the consolidated financial margin, including the effect of the non-recurring items, the financial margin increased by Ps 1.5 billion, increasing 80%.

Provisions for loan losses reached Ps 286 million this quarter. In terms of (inaudible) risk, this quarter reported 5%. The increase in the cost of risk is in line with portfolio growth, portfolio diversification and mostly due to the standardization of charge-off policies between the foreign subsidiaries. Important to mention as well is that during the quarter we recovered around Ps 100 million of charge-off accounts reflected on the Other Income line on our P&L. Considering this portfolio recovery, the cost of risk would have reached 3.3%. Year-to-date, the cost of risk reported at 3.2% for the full year and this metric should be close to the 4%.

Administrative expenses, those reached Ps 805 million during the third quarter of 2016 showing a 185 increase when compared to the third quarter of ’15 figure. The increase is mainly driven by the consolidations of AFS, Resuelve and Instacredit and Don Carro expenses. Excluding these recent acquisitions and their G&A, we have increased only 0.7%.

Net income interest in the third quarter of ’16 increased by 10.9%, reaching Ps 376 million compared to the Ps 339 million posted during third quarter on a recurring basis. The net income for the quarter was affected by Ps 46 million due to the negative carry. Excluding that event, the net income has been increased by 24.4%. Including of the non-recurring item, the net income increased 73% to reach Ps 587 million.

In terms of key financial ratios, during the quarter we achieved a return on assets of 4.3% and a return on equity of 17.8% which compares with 6% and 22.1% reported in the previous year. The ROA and ROE reflects the negative carry consisting on investments in securities on the balance sheet that amounts for Ps 3.2 billion and on the P&L decreasing the net income by 46 million. Excluding those items the ROA would have reached 5.1% and the ROE 20%.

The quarter’s efficiency ratio reached 60.7%, reflecting again the consolidation of Instacredit, AFS, Don Carro and Resuelve expenses, and the network distribution expansion of our subsidiaries. Excluding these application effects and the negative carry again, efficiency ratio would have reached 37%, a figure very comparable to the 34% and 37% reported on the second quarter of ’15 and the second quarter of ’16, respectively.

Our capitalization index reached 38% compared to the same quarter of ’15, even after the increase of debt to finance to—even after the increased debt to finance to finance our recent acquisitions. Crédito Real still has a capitalization ratio that is well above the average of the financial sector.

Our loan portfolio increased by 40% to reach Ps 22.8 billion at the end of the third quarter of ‘16 compared to Ps 16.3 billion recorded at the end of third quarter of ‘15. The organic growth was approximately 17% which was driven by payroll and the used car businesses. Inorganic growth represented 22% boosted by the consolidation of Instacredit.

We keep supporting our payroll portfolio growth with pensioners. This quarter represented 25% of the total of our origination. Also, nearly 88% of our new loans came from the three main distributors in which we own equity.

Our SME portfolio decreased 27% to end up the quarter with a outstanding balance of Ps 1.4 billion. The third quarter was less dynamic and our outlook has short-term duration because it attends SME working capital needs. Also, the decrease is explained by the tight credit policies and was negatively affected by the repricing of the Mexican interest rate tax.

Our durable goods portfolio decreased 50% compared to the third quarter of '15 and as we have said previously, the privileged asset quality of our growth. In general we maintain tight credit policies. As we mentioned last quarter, we decided to gradually exit from the traditional durable goods business considering that the industry has become mature and highly competitive.

In the group loan business, our operators Contigo and SomosUno, reported a 29% loan portfolio expansion. As we have previously disclosed, our balance sheet only recognizes the funding provided to our partners in which we own equity. The group loan portfolio in our balance sheet reached Ps 328 million, but the loan portfolio of our partners reached almost Ps 650 million. Our group loan partners also maintained asset quality as seen in the 1.1% NPL reported this quarter. As of the third quarter of '16, our group loan network serves more than 190,000 active customers.

In terms of originations, we posted a 32% growth and without the Instacredit consolidation, it increased almost by 10%. The group loan and used cars originations also experienced a good growth rate. We have made important diversification attempts and nowadays only 25% of the originations came from the payroll loans.

Non-performing loans portfolio was 2.5% this quarter compared to 2% ratio last year. The increase in the NPL of the Company was mainly caused by the used car business that is explained by the expansion in our USA used car business expansion and in which NPLs are well above those of the Mexican business. Instacredit consolidation as well contributed to this increase in the NPL since they have higher NPLs but also higher returns. Overall, the NPL is in line with the 2% to 3% long-term objective as we attain larger diversification.

Allowances for loan losses for this quarter was Ps 803 million with a 1.4 times coverage ratio. The allowance for loan losses increased in line with non-performing loans and portfolio growth.

With this, I conclude my remarks. Now let me turn the back the call to the Operator to open the line for Q&A.

Operator:

Thank you. If you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you are using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, please press star, one to ask a question. Also, please state your name and company name before asking your question. We'll pause for just a moment to allow everyone an opportunity to signal for questions.

We do have our first question. Please go ahead, sir. Your line is open.

Benjamin:

Whose line?

Male Speaker:

Benjamin.

Benjamin:

Yes. Didn't hear that one. Sorry for that one. Good morning, Angel and Carlos. First of all congratulations I guess on the results that were nonetheless a little confusing. I have actually just one question. I mean it makes totally sense and you very nicely disclosed the implications from the non-recurring gain you had recognized, but then obviously throughout the text you talk a lot about the negative implications which you still have because of the carry. Those Ps 66 million, just to understand, is that something we should expect to see as well of some sort in the fourth quarter? Is that something that has now been unwinded? What's the ultimate result here going to be and how should we think that put into consideration about let's say the recurring reported net income growth for this year? Because obviously the final reported one is going to be nonetheless very strong because of the non-recurring effect, but just to understand how that—the relative thing, how long is this going to impact you on the interest expense side? That would be my question.

Angel Romanos:

Hello Benjamin. This is Angel. We're planning to keep the cash at least through the US election and we have to keep some of it also until February when we have the option to purchase the other 30% of the bond that was not—that didn't got to the tender offer. We plan to keep that cash and the cash we have today until at least the 9th of November. We think it's good on our side to have a good cash position in case volatility comes abroad and a negative effect comes to the financial markets in general. So we should have that effect at least for half of the quarter, the hold effect.

Benjamin:

It's going to be—just to my understanding now it was about on your cost of funds and you've disclosed it very nicely with that bar chart, that it made up for about 0.6% out of the total 9.5. So if we—are we right to assume that this is going to be the 0.6, because if I remember, the tender was pretty early in the quarter but remind me quickly is this going to be a little more or is it going to be a little less? What's the impact here on your cost of funds? What should be assume, let's say for the next at least two quarters.

Carlos Ochoa:

I mean it should probably be about the same. The transaction, we issued that transaction, that was back in July 20, but as of today I mean we have used some of the loan resources so the negative carry is going to diminish in the sense that we are using or we are investing more effective, more efficiently those extra resources, but definitely, as Angel was mentioning, you know the whole purpose of the transaction was to be more conservative, being conservative on the conservative side. The refinancing all the US dollar denominated debt in order to avoid any external shocks on the economy.

I would say that it should remain about the same, you know, in the range of the 0.6%, 0.5% additional cost of funds.

Benjamin:

Okay. Makes totally sense. Then just one, I forgot. That one I highlighted it here. So you mentioned in the press release that if there would be a 100 basis point increase on the interest rate in Mexico and the US, that would have a negative impact of 3% on your net income. That's for net income growth 2017? Or is that—because we have seen already, well, a decent increase here in Mexico. Is that already something that affects you considering that there was basically no increase in the US but a significant increase in Mexico? So that 3% number, is that for 2017 or is that something for 2016?

Carlos Ochoa:

That's hypothetical in the sense that would be for the 2017 because already the cost of funds that you have seen right now, they already incorporated the 100 basis that we have experienced over the last few months, almost a year. So that would be for the next year.

Benjamin:

Yes, so it should be just a minor increase due to the most recent 50 basis point hike we had about a month ago, right?

Carlos Ochoa:

Right.

Benjamin:

Because that's likely to affect a little bit the fourth quarter.

Carlos Ochoa:

Right. The thing is that the main driver of that one is going to be the outcome of the US election. So that's what we are …

Benjamin:

(Inaudible), right?

Carlos Ochoa:

Pretty much. Pretty much, Benjamin.

Benjamin:

Okay, perfect. That's all on my side and thank you very much for the clarification. Congrats again for the results.

Angel Romanos:

Thank you.

Carlos Ochoa:

Thank you, Benjamin.

Operator:

Again, that is star, one to ask a question. Please state your name and company name before asking your question. We will take our next question. Please go ahead, sir. Your line is open.

Jordan:

This is Jordan Hunworth (phon) with (Inaudible) Financial. Can you hear me?

Carlos Ochoa:

We can hear you, Jordan.

Jordan:

Thanks. Two questions. When you talk about that extra 41 million, is that on the operating line or is that on the net income line? From this quarter, the balance sheet effects.

Carlos Ochoa:

Excuse me, come again.

Jordan:

You mentioned that if it wasn't for the extra balance sheet liquidity you would have had an extra 41 million, I believe. Is that on the operating line or the net income line?

Carlos Ochoa:

On the net income.

Jordan:

Okay. So it would have been the same tax rate basically.

Carlos Ochoa:

That's correct.

Jordan:

So it was always a below normal tax rate this quarter is what I'm trying to get at.

Carlos Ochoa:

Excuse me, come again.

Jordan:

There was a below normal tax rate a little bit this quarter.

Carlos Ochoa:

Yes, normally that's affected by the consolidation. The effect of the consolidation of the subsidiaries, especially those in the (inaudible).

Jordan:

So what would be a normal tax rate going forward?

Carlos Ochoa:

We should be expecting something in the range of the 27%.

Jordan:

Okay, thanks. When you start to think about next year, this year has been a consolidation year and you've done an excellent job and you've grown loans, but the net income growth has not been as much. Are we still forecasting at least a 15% net income growth next year in '17 over '16?

Carlos Ochoa:

Yes, we definitely—what we expect in terms of net income, our guidance and we haven't changed that, is going to—it should be growing. For the next year it should be growing 15% to 18%, and in terms of the book, that should be growing 15% to 20%, and we feel confident about those as well.

Jordan:

That's with the same tax rate.

Carlos Ochoa:

That's with the same tax rate, yes.

Jordan:

Okay. Thank you.

Angel Romanos:

Thank you, Jordan.

Carlos Ochoa:

Thanks.

Operator:

Again that is star, one to ask a question. We have no further phone questions at this time.

Again, there are no further phone questions.

Angel Romanos:

Thank you, Operator.

Operator:

You're welcome.

Carlos Ochoa:

Thank you all for taking part in this conference call.

Operator:

This concludes today's conference. Thank you for your participation. You may now disconnect.