October 26, 2017

10:00 AM CT

Operator: The following is a recording for Manuel Perez of IRSTRAT on Thursday, October 26, 2017 at 10:00 AM Central Time. This is the Credito Real third quarter 2017 Conference Call. Good morning and welcome everyone to the Credito Real third quarter 2017 Earnings Conference Call. Credito Real issued its quarterly report on Wednesday, October 25, 2017. If you did not receive a copy via email, please do not hesitate to contact us in Mexico City at +52-55-52289753. It is important to note that the presentation and the MP3 recording referred to in this call will be available at www.creal.mx. Before we begin the call today, I would like to remind you that the information discussed in today's call may include forward-looking statement on Credito Real's future financial performance and prospects which are subject to risks and uncertainties. Actual results may differ materially and the company cautions not to rely unduly on these forward-looking statements. The Company undertakes no obligation to publicly update or revise any forward-looking statement. With us this morning from Credito Real, are Mr. Angel Romanos, CEO and Mr. Carlos Ochoa, Deputy CEO. They will discuss on the more important and strategic financial and operating aspects of the third quarter 2017. I would now like to turn the call over to Mr. Romanos.

Angel Romanos: Good morning everyone, and thanks for your participation. I am pleased to inform you about our results for the third quarter 2017 continue consolidating the positive trend of our operation of improvement throughout the year and we have been able to benefit from the macroeconomic stability of the markets where we operate, mostly from Mexico. In this context, net income of the period totaled Ps. 403 million, 7 percent above that in the same quarter of last year on a comparable basis, isolated from non-recurrent items. This enhancement in our profitability was supported by our solid underlying fundamentals as our best-in-class NPL which closed the quarter at 2.3 percent level. Recording no impact from the recent earthquakes in Mexico our delinquency rate level in the states affected remained almost unchanged. It is important to mention that good results follow a successive trend of the continuous addition of high quality assets which allow us to grow with stability and profitability at the same time. Breaking down results by different segments, payroll registered Ps. 1.4 billion credit origination growing at a solid 26 percent annual rate. Instacredit maintained its consolidation track and continued delivering (inaudible 03:04) of growth. In contrast, cars segment registered a Ps. 431 million origination remunerating its growth trend as a result of Hurricane Harvey affecting Texas and Florida, where Don Carro and AFS have a significant presence. Although as soon as the next quarter we expect a normalized operation in this segment as a considerable number of motor cars need to be replaced from irreparable damage due to Harvey Hurricane. In the aftermath at a consolidated level the credit origination of Credito Real amounted to Ps. 4.6 billion. On the funding front, the cost of financing increased in an annual basis of 160 basis points. That is way below and the Interbank interest rate has increased. This incremental cost was offset by both higher operational efficiencies and a comprehensive credit origination as the rate terms of new loans is continuously adjusted to rising reference rate. Now elaborating in the recent developments were executed by issue of three admission of local notes on the (inaudible 04:28) Replacement Program. Jointly amounted for Ps. 700 million with a solid over subscription of 1.3 X. A portion of these proceeds were used for the full amortization of local notes issued on March 2017 for Ps. 250 million. In risk management wise, at quarter end we were covered on interest and exchange rate fluctuations as a fixed rate portion of our debt swept past the 50 percent mark and our dollar position exposure is 100 percent hedged, bringing certainty and stability to our operations. Lots of luck we moved forward towards year end with a strengthened business platform that is proving solid resiliency to prosper even in troubled waters. Meanwhile, (inaudible 05:20) on Instacredit are continuously leaving behind now receiving positive feedback from investors who were hesitating at the beginning a strong signal that we are doing right and a solid stimulus to further benefit from our better clarity in this platform which has clearly succeeded with Instacredit consolidation. On another note, I would like to express my gratitude to Mr. Alfredo Castillo for his valuable work and dedication as a board member of Credito Real over all these years. Let's all wish him the best of luck in his future endeavors. To conclude, with solid grounds in our operational metrics and good results in hand we will continue striving to enhance our business platform and commercial footprint seeking to increase profitability in a framework of strongest control and balance sheet preservation. With this, I want to thank you again and leave your call with Carlos Ochoa. Thank you very much.

Carlos Ochoa: Thank you, Angel. Good morning and thank you all for taking part in Credito Real's Quarterly Conference Call. Regarding the interest income during this quarter we reached interest income of Ps. 2.1 billion increasing almost 13 percent compared to 3Q16. This was mainly due to the growth in the loan portfolio supported mainly by payroll which contributed 62 percent to the consolidated net interest income. Regarding expenses average cost of funds raised to 11.2 percent, an increase of 160 basis points when compared to the 9.6 percent in the 3Q16. This increase is explained by an interest in Mexican reference rate. The financial margin increased 10.7 percent to Ps. 1.4 billion driven by interest income growth. Therefore, the net interest margin achieved 21.5 percent in 3Q17. Thus our international businesses contributed 38 percent to the consolidated financial margin. Provisions for loan losses reached Ps. 355 million. The increase is mainly due to some payment delay in the payroll business associated to September's earthquake in Mexico and provisions have just estimated Instacredit. Cost of risk during this quarter was 5.2 percent compared to the 5 percent in the third quarter of '16 as a result of the increase of the provisions for loan losses line. However, due to the recovery of the charge off account which totaled Ps. 76.2 million, the provision line would have decreased to Ps. 278.7 million. Therefore, the cost of risk would have been 4.2 percent. Commissions and fees collected increased 35 percent during 3Q17, Ps. 286.8 million compared to the 3Q16. Integrated by Ps. 121 million commissions collected from Resuelve and Ps. 65.4 million from Instacredit. Administrative expenses reached Ps. 806 million during the third quarter of '17, showing a .1 percent increase when compared to the Ps. 805 million we saw in the third quarter of '16. As of the third quarter of '17 net income reached Ps. 403 million showing an increase of 7 percent over the 3Q17 year on year. This keeps us on track for our 2017 guidance. Regarding key financial ratios, ROE reached 17.5 percent during the quarter with ROA reaching 4.6 percent. The quarter's efficiency ratio increased to 49 percent compared to the 48.2 percent in 3Q16. In the 4Q16 the efficiency ratio calculation experienced Resuelve since this business does not involve credit risk. This quarter the cost of risk was 5.2 percent compared to the 5 percent in 3Q16 as a result of the increase in the provisions for loan losses line. Regarding our loan portfolio it increased by 17.1 percent to Ps. 26.7 billion at the end of 3Q17 driven by the double-digit growth in the payroll, SMEs and Instacredit. Our payroll portfolio increased by 22.8 percent to Ps. 17.6 billion supported by the pensioner segment which represented 31 percent of the total payroll origination during the quarter. Almost 87 percent of payroll loans originated during the quarter derived from our three main distributors in which we own equity. In addition, very important to remark that the NPL decreased to 1.5 percent in 3Q17 from a 2.4 percent in 3Q16. Our SME portfolio increased by 22.1 percent year on year, totaling Ps. 1.7 billion as of 3Q17. We extended though the average loan terms and average loan amounts striving to focus on larger accounts. Our yield portfolio is slightly decreased 2.1 percent YoY reaching Ps. 2.5 billion at the end of the third quarter 2017, while origination amounted Ps. 430 million in the quarter. Instacredit's loan portfolio reached Ps. 4.2 billion showing an increase of 17 percent year on year and representing 16 percent of the total loan portfolio with an NPL of 5.4 percent. The line others is integrated by durable goods and group loan businesses which would reduce the loan portfolio worth of Ps. 576 million during the quarter, decreasing 34.5 percent driven by the divestment in durable goods. Moreover, the origination reached Ps. 1.3 million increasing 25.7 percent YoY driven by group loans. This quarter the consolidated non-performing loan portfolio was 2.3 percent compared to the 2.5 percent last year. The NPL improved mainly in payroll and used car businesses still in line with a 2 percent to 3 percent long term objective as we move forward with greater loan portfolio diversifications. With this I conclude my remarks and now let me turn back the call to the operator to open the line for the Q&A.

Operator: Thank you, sir. Ladies and gentlemen, to ask a question please press the * key followed by the 1 key, that is *1 on your touchtone phones. If you are using a speaker phone, please make sure that your mute function is turned off to allow your signal to reach the equipment. Again, that is *1 if you would like to ask a question. Our first question comes from Benjamin Theurer from Barclays.

Benjamin Theurer: Good morning Angel, good morning Carlos. First of all, congratulations on the results. I just wanted to follow-up on the provision for loan losses. Clearly you mentioned that there was an increase post the earthquake delays and that all makes sense but just to get a better feeling, now at about Ps. 355 million and it was more on average around about Ps. 300 million in the first half on each quarter. Is that something, what's the level of recovery we should expect here to see for the quarterly figure into 4Q? Have you seen those payments coming in now about six weeks after? Just to a little bit of a sense of where we're heading to for the rest of the world and then obviously into 2018, would you think this is going to be a sustainable level going forward? Thanks.

Angel Romanos: Hi Ben. Well, in that sense the way we see things and the way we suspect is that you have a total cost of risk around 4.5 percent and that net out of the other income from the operations and in the collections that we get from the charge off accounts. This quarter was unusual in two ways. The first one was, as we mentioned already, the delays in some government agencies caused by the week that they didn't work but that money, those payments were already recovered in the first couple of weeks of this month of October. And on the other hand what we have is in the case of Instacredit the NPLs have been increasing over the last couple of quarters but however, that portfolio is contained within, as an NPL so we haven't been charging off those accounts. We are making a lot of efforts in place in Central America in order to contain the portfolio and I am positive that the provision line will be in line with what we have seen in the past which were those Ps. 300 million that you mentioned more or less.

Benjamin Theurer: Okay. Perfect. Thank you very much, very clear.

Angel Romanos: Thank you, Ben.

Operator: Thank you. Our next question comes from Tito Labarta from Scotia Bank.

Tito Labarta: Hi good morning, Angel and Carlos. Thanks for the call. A couple of questions. First, on your loan growth you saw very good loan growth particularly in payroll loans. I just wanted to understand a little bit more what's driving that growth. Is it sustainable to continue to grow at that 20+ percent that you're growing in payroll loans, or what is a more normalized level that we should expect? Second question is your margins also saw good movement in your margin. Funding costs seems to have stabilized, and yield on your loans. Is there room for any more margin extension? Is this what we should expect going forward, if you can give me some color on that, that would be helpful? Thank you.

Carlos Ochoa: Hi Tito. Thanks for your questions. First, regarding the payroll business and what we've seen is that we expect that dynamic to continue at least for the remaining of the year. And what we've seen this quarter as well, is that we are confident that trend should continue for the remaining of the year. The way we are doing it is the commercial efforts that the distributors have been doing over the last few months is to increase the penetration in the government agencies we work with and that's proven to be successful as you can see from the growth rate. Yes, we believe that this trend should continue for the next few quarters. When it comes to the financial margin, I mean at least if you see the trend that Tier has followed here in Mexico, year over year the Tier has increased by 230 basis points. In the case of our cost of funds the increase was only 660 basis points. This is mainly explained because as you remember during the 1st Quarter we started fixing a portion of our debt. We believe that in this scenario where we believe that the interest rate type of cycle has come to an end in Mexico or at least we wouldn't expect an increase as dramatic as we have seen. We believe the net interest margin should be around 22 percent, 21-1/2 to 22 percent.

Tito Labarta: Great. Thanks, Carlos, that's helpful. Maybe one follow-up then. Given the trends that you're seeing with loans growing better than expected, good margins you mentioned in the previous question from then provisions should come down next quarter. Do you think then there are some upside risks to your net income guidance given what you make in the fourth quarter?

Carlos Ochoa: No, I mean right now we feel confident that the trends that we are seeing both in terms of growth and in terms of net income could continue to the end of the year. That's basically our reasoning. I mean we feel very confident about the top of the PNL. If you could see the income is growing and the way the financial margin is growing and the way that we are containing the SG&A line, I mean we believe that once that we get to seek the provision line which is done as we should be doing over the next few weeks, the trends that we've seen could continue by the year end.

Tito Labarta: Right. Yeah, I guess that's what I was referring to given the trends you're seeing you could probably surpass the 5 percent earnings growth that you had guided for, is that reasonable to think that it could be higher than that?

Carlos Ochoa: Hopefully it is.

Tito Labarta: Okay, fair enough. Thank you.

Operator: Thank you. Once again, if you would like to ask a question please press *1 at this time. Our next question comes from Alessandro Arlant from Bank of America.

Alessandro Arlant: Hello, thank you for taking my call. Just a couple questions please. Just going back on the debt of the Company you mentioned on the call that the dollar debt is now 100 percent hedged. This is both the coupon payments and the principal payments just checking on that.

Carlos Ochoa: That is correct. Except for $75 million of the last year's senior note issuance which were completely devoted to our operations in the states. Everything for the rest of the senior notes as well as the 2019s, they are fully hedged with a full cross currency swap.

Alessandro Arlant: And just again just updating on the fixed cost of that I think you reached 53 percent and this is the level that you want, I mean when we look at your derivative position you have fixed cost debt of 53 percent of total and that you're going to keep it at this level going forward.

Carlos Ochoa: Yes, we feel comfortable that way.

Alessandro Arlant: Also you have the 2019 bonds, there's a call coming up I think next month in November, the end of November. Any intention to exercising that call?

Carlos Ochoa: We are still deciding what's going to be the best strategy to follow on that one.

Alessandro Arlant: Okay. Then just my final questions, if I may. I also just want an update on Maestro Auction. I think you have until the end of this year to exercise that. Are negotiations ongoing and can we expect anything as of the end of the year.

Carlos Ochoa: I mean right now the focus, we are focusing more on the commercial part of the business on reaching the same growth rate that we've been experiencing and at the same time we keep talking with the Credito Maestro top management. I mean we have a very profitable association with them as it is now but who knows? It will depend on the benefits that we could achieve on both sides.

Alessandro Arlant: Then they have a put option also, right? Is it this year, next year?

Carlos Ochoa: Yes, it's correct. They have a put option for next year.

Alessandro Arlant: Is it throughout the year? Is there an expiry date? Is there any, throughout 2018.

Carlos Ochoa: Throughout the year. That is correct.

Alessandro Arlant: Is there a value assigned to that?

Carlos Ochoa: No. I mean, no, we haven't decided that.

Alessandro Arlant: Okay, that's great. Thank you so much for answering my questions. I appreciate it.

Carlos Ochoa: My pleasure. Thanks.

Operator: As a final reminder, please press *1 at this time for any questions. Again that is *1 at this time for any questions. Our next question comes from Ernesto Gabilondo from Bank of America.

Ernesto Gabilondo: Hi, good morning, Carlos, and thanks for taking my call. Just a couple of questions. The first one is in terms of your expectations on net income and ROE for the year end. I just want to know if you see at the end of the year a normalization of the provisions taking into consideration the payment in payroll loans if you are thinking to achieve your guidance. My second question is related to the used car loan business. We have seen some noises regarding what is happening with the US. We just want to know if we have already saw the difficult part about this and if you expect this to trend up at some point. Thank you.

Carlos Ochoa: Hi Ernesto. Well basically regarding the ROE we believe is that we continue the same trends that we've been seeing for these three quarters. We should around the 18 percent or the 19 percent ROE probably between those two. I mean what we are definitely sure is that the provision line should normalize over this fourth quarter given all the efforts that we are taking in order to contain the NPLs in the Instacredit business and also knowing that the government agencies that caused the delays in the payroll payments from some specific government agencies have already solved that one. So our view in terms of ROE is that we should be something in line between the 18 percent and the 19 percent for year end. On the other hand, regarding your questions about the used car business specifically in the states, you know the thing that we considered that has been affecting us the most is the changes in the political landscape over there in the states more than the general markets of the depression of the used car prices or things like that. Right now what we are experiencing is some challenges in the commercial side of the business given the specific segment of the population that we are targeting has become more cautious. That's our perception that the specific segment that we are commercial targeting have become more cautious given the political landscape and the regulatory framework that they are experiencing. We definitely I would wrap that up by saying that we are very confident about our foreign business on both of them, specifically in the case of the used car business in the states is definitely become one of the major parts of our book within a few years and we are just coping with what we expect are temporary challenges.

Ernesto Gabilondo: Thank you, Carlos.

Carlos Ochoa: Thank you, Ernesto.

Operator: Thank you. Our next question comes from Natalia Corfield from JP Morgan.

Natalia Corfield: Hi good morning and thank you for taking my question. It's related to your derivative position. You had a gain in this quarter of Ps. 126.4 million and it's written in the press release that this is the result in valuation of the derivative positions. I would like to know exactly what these are and also you had previously in your asset side a big derivative portion that I believe was related to the hedge of your bonds. But it decreased in the past quarter and is no longer there this quarter. I'm wondering if this is related to the appreciation of the currency, if you could give any color on that, it would be also very much appreciated. Thank you.

Carlos Ochoa: Hi Natalia. Definitely that has everything to do with the FX. If you look at the FX rate specifically for the third quarter, at the end of the 3rd Q of 16, that was in the neighborhood of 19.40 per dollar. As it is today at the end of the quarter it was pretty much in the 18.20 or something. That valuation was what cost most of the changes in these two lines. When you come to specifically what you see on the balance sheet, that was mainly mark to market that we used to have. Just to remind you the full cross currency swaps that we have for the 2019, the strike prices are 14.50 pesos per dollar, where the 2023 the strike price was then 18.89. We used to have a massive mark to market in those lines. Now what we experienced for the first time you know given the value that at its lowest potential reached something like 17.60 or something like that. We had the opposite effects on the valuation of those, we had the opposite effect on the mark to market specifically and on the valuation of the derivation. That you tend to see, if you go to the liability side you can see one different line, the Ps. 274.4 during this quarter under the line securities and derivatives transaction. Now we have the opposite of what we have on the mark to market now we have on the asset side. Now we have this amount almost Ps. 275 million on the liability side due to the fluctuations of the FX.

Natalia Corfield: Right. It's very clear. In the next quarter if the depreciation of the currency continues then we should see for instance a negative results related to your derivative position.

Carlos Ochoa: Yes. We should see a reversal of the effect that you're seeing right now.

Natalia Corfield: Okay. Alright.

Carlos Ochoa: At the current level, I mean the way we see at the current level shouldn't be that material but it's hard to say.

Natalia Corfield: No, it's clear, thank you very much.

Carlos Ochoa: Thank you, Natalia.

Operator: Thank you. With no further questions in the queue, the question and answer session concludes. Thank you for being in today's conference call. You may now disconnect. Have a great day.

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