4Q19 Earnings Call Transcript

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10:00 AM CT

Operator: This is a recording of the Manuel Perez conference with IRSTRAT S.A. de C.V. on Thursday February 20th, 2020 at 10:00 AM CT. Ladies and gentlemen, good morning, and welcome, everyone, to Crédito Real's Fourth quarter 2019 Earnings Conference Call. Crédito Real issued its quarterly report on Wednesday, February 19th, 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, is Mr. Carlos Ochoa, Deputy CEO. He will be discussing on the more important strategic financial and operating aspects of the fourth quarter 2019. I would now turn the call over to Mr. Ochoa. Please go ahead, sir.

Carlos Ochoa: Thank you, operator. Good morning everyone and thank you for joining us today. I am happy to share another year of positive results, as Crédito Real posted solid portfolio dynamics across all its business segments and geographies during 2019, enabling us to achieve a 29.3% growth rate in consolidated terms, above 20%, the target set at our Guidance; and, stable bottom line results, as we decided to privilege asset quality and liquidity in year 2019, looking for the greater benefit towards the medium and long run rather than synthetically stimulate short term results. At the same time, as of December 31st, 2019, we already served over 916 thousand clients across Mexico, the United States and Central America, compared to almost 852 thousand a year ago, thus paving the way for beating the iconic 1 million mark. This performance becomes more significant when realize the softer macroeconomic conditions prevailing in Mexico, our main market, and the political unrest in Nicaragua. As we have seen consistently throughout 2019, our resilient operations in Mexico, combined with a more stable and cost-efficient structure of the international businesses, contributed meaningfully to bring forth additional drivers of sustained growth. In this regard, it is worth noting that, as of quarter-end, the contribution of international businesses to both consolidated loan portfolio and net interest margin, stood at 21% and 47%, respectively, in line with our diversification targets. Before going further on the analysis of our performance by geography and business segment, allow me to take you through some significant milestones achieved in 2019. First, pursuant of our commitment for delivering incremental value to our investors, we cancelled over 12 million shares, equivalent to 3.2% of the outstanding stock in year 2019, ending with 379.7 million shares outstanding, drawing on an ambitious 8.5 billion pesos buyback program; while, paid over 266 million pesos in cash dividends; the highest distribution ever made in Crédito Real's history. Second, through the international offering of 350 million euros Senior Notes due 2027, we became the first Mexican non-bank financial institution to issue euro-denominated debt and the only high-yield Latin-American company to perform this type of issuances in the last 5 years. This transaction was particularly significant as it enabled us not only to push forward our funding strategy, but also to strengthen our investor base, as we were able to attract blue-chip institutional investors, lured by our differentiated value proposal and our financial inclusion. Lastly, we held our first-ever investor day in New York City, where I and other senior officers had the pleasure to meet, listen and to speak with our share and stakeholders. In this space, we were also able to gather very valuable feedback to better align our core strategies and overall business plan to our shareholders' interests going forward. Turning to the business segments' developments. In Mexico, our operations showed wider stability in terms of loan origination across all credit portfolios, despite a lower economic activity, which certainly led us to adopt a conservative approach to guarantee the asset quality preservation. In the case of Payroll, origination normalization advances, as this quarter contraction was around 5%, after reaching double-digit growth rates of decline in previous quarters, as we started to regain traction in the addition of clients with solid credit profiles, in our target markets. On the other hand, origination growth rates in the SMEs segment kept its strong pace, increasing 1.5 times year-over-year this quarter, at the back of the success achieved by our comprehensive offering. Consequently, we feel confident to capitalize on the vastly underserved base of potential customers. In this regard, we have recently arranged a credit facility with the IDB Invest, for 50 million dollars; seeking to originate incremental credits for the entrepreneur women of Mexico. Likewise, it is relevant to underscore the increasing participation of SMEs in our consolidated loan portfolio since the introduction of the pure leasing product in 2018. To put that in perspective, SMEs loan portfolio accounted for only 10% of the consolidated loan portfolio as of 4Q18, compared to approximately 16% as of year-end 2019. On Used Cars business in Mexico, origination momentum continues, fueled by demand surge for pre-owned cars. Wrapping up, our loan portfolio in Mexico stood above the 37 billion pesos mark, 27% more than that of the same period last year. Meanwhile, its non-performing loan ratio stood at 1%, its lowest mark in 5 years; posting sequential and annual improvements of 30 and 10 basis points, respectively, as we continued succeeding in the implementation of smart origination standards. Moving to our international businesses, the turnaround started in the USA last year continues to fuel positive results, as Crédito Real USA reported a solid quarter, with a loan origination growth of 1.68 times, delinquency improving to 0.9%, from 1.1% as of year-end 2018, alongside a positive generation of cash. This performance was driven by the efforts oriented to stimulate cross selling and consolidate a commercial structure of higher penetration among the Hispanic population. On Central America, we continued seeing a further recovery, in line with a more stable environment, as loan origination dynamics remained positive. In this segment, we posted a double-digit growth rate and a non-performing loan ratio improvement, which allowed us to attain a quarterly net income of approximately 110 million pesos. Now, I would like to take a moment to walk you through some relevant achievements that positively impacted the Balance Sheet. As I mentioned earlier, we signed a 50-million-dollar credit line with the IDB Invest, our current cheapest source of funding; allowing us to improve our debt mix. In this sense, it is important to underscore our keen interest to increase the participation of this type of financing going forward, as we seek to tap into the attractive conditions offered by development banks. Additionally, we successfully completed the issuance of 750 million pesos local notes under our portfolio securitization program. The aforementioned, coupled with the record collection registered in December, contributed to bolstering liquidity, as shown by our cash balance, that as of year-end surpasses the 1 billion pesos mark. Likewise, seeking to channel all possible resources toward the businesses that best fit our profitability standards, we reduced our stake in Resuelve. It is important to clarify that this action will not take any toll to our consolidated resources and will allow us to maximize the use of resources for our strategic assets. All-in-all, we head into 2020 on a solid footing, as the foundations we have laid out on the last decade has resulted in a resilient and flexible platform, capable of face tougher and increasingly complex challenges. And, confident to reach positive results, drawing on our compact, but efficient structure, and our solid financial position, which will allow us to tap into the favorable environment of interest rates that follows the easing cycle started by central banks in North America. In this context, for our 2020 guidance we set a 15% to 20% growth target for our consolidated loan portfolio; and, double-digit net income growth. On a final note, I would like to express my gratitude to our customers, partners, associates and shareholders, who helped us achieve another successful year in our crusade to provide accessible credit products for the underserved segment of the population. Moving to discuss our financial in greater detail. During the fourth quarter of 2019, interest income totaled 3.3 billion pesos, that is over 20% more than that of the same period last year, as a result of the strong growth registered in the consolidated loan portfolio. For the full-year 2019, interest income increased 17.0%, reaching 11.9 billion pesos. Interest expense recorded 1.3 billion pesos, an annual increase of 619 million pesos, roughly 89%, mainly derived from the Company's larger indebtedness. For the year 2019, interest expense amounted 4.7 billion pesos, up nearly 50% on a year-over-year basis. Consequently, financial margin was about 2 billion pesos for the fourth quarter, down 3% or 61 million pesos when compared to that of the last year. This variation is explained by a non-recurring effect associated to the liability management exercise that we performed in the quarter, higher debt costs and changes in the product mix from the addition of above-average quality assets. 2019 financial margin totaled 7.3 billion pesos, an increase of 2.6% when compared to year 2018. Net provision for loan losses, including the recovery of charged-off accounts as requested by the CNBV, was 350 million pesos, decreasing 32 million pesos or 8.3% on an annual basis, reflecting an overall improvement in delinquency levels. The annual figure for this P&L item attained about 1.3 billion pesos, contracting 15.2% against 2018. The coverage ratio stood close to 220%, compared to 178.8% and 173% in the previous quarter of the same period in the last couple of years, reflecting the ongoing improvement of the asset quality. Administrative and promotion expenses summed up 972 million pesos, increasing 193 million pesos or 24.8% against the figure recorded in the same period last year, explained by portfolio growth-related expenses, and debt issuance costs. 2019 administrative and promotion expenses rose 3.6%, totaling 3.6 billion pesos. It is important to mention that, during the quarter a non-recurring expense for 143 million pesos was recorded, following the premium paid for the Senior Notes 2023 tender offer as a result of the liability management of the euro-denominated Senior Notes. Consequently, net income amounted to 427 million pesos. Excluding this non-recurring effect, comparable net income rose to 570 million pesos. Return on Average Equity stood at 12.3% in 2019, while excluding the Perpetual Notes' premium, this metric stood at 16.6%. On the other end, Return on Average Assets was 3.6%. Capitalization Ratio contracted by 970 basis points on a year-over-year basis, standing at 34.2% in 2019. The average cost of funds remained flat, on a sequential basis, at 13.3%, as a result of lower borrowing costs associated to the credit facilities arranged over the past months and recent reference rate cuts. And, in a normalized basis, lies below the 12.5% mark. For the year 2020, we anticipate a stable funding cost, and foreseeing arising opportunities from more competitive reference rates. Turning to the loan portfolio performance. Consolidated loan portfolio totaled 46.9 billion pesos as of quarter-end, an annual growth of 29.3%, fueled by an overall positive performance of our business segments; outstanding SMEs and the United States businesses. Consolidated Small and Medium-sized Enterprises portfolio reached 7.4 billion pesos, increasing 103% year-over-year, driven by a strong demand for our credit solutions, especially leasing. And, as I just mentioned earlier, the participation of this segment in the consolidated portfolio has solidly increased, improving our product mix. Payroll portfolio amounted to 28.2 billion pesos, up 13.8% when compared to the 24.8 billion pesos recorded in 2018. Here it is important to mention that our growth trend has started to surge during the fourth quarter, and possibly gain further traction in the periods to come. As for the used car business in Mexico, this amounted to 1.4 billion pesos, up 52.7% versus year over year, in consonance with a growing demand. In the United States front, our portfolio reached 4.1 billion pesos, a 101% year-over-year growth, highly contributing to our consolidated portfolio expansion, and financial margin growth. In that regard, we have grounds to expect resilient dynamics in this segment towards 2020, as the prospects of economic activity seem stable, drawing from a controlled inflation, lower interest rates and lesser uncertainty, given the USMCA approval by both the President and Congress of the both countries, United States and Mexico. Meanwhile, Instacredit's loan portfolio reached 4.9 billion pesos, a year-over-year growth of 10.2%, mainly derived from the ongoing implementation of initiatives aimed at consolidating wider resiliency and efficiency, coupled with a more stable environment. At the light of these developments, it is important to state that we are heavily caring origination standards, as we seek to preserve our asset quality and financial resources. Therefore, the consolidated non-performing loan ratio declined to 1.3%, from that of 1.7% in the fourth quarter 2018. Now, turning to the balance sheet. As of December 31st, 2019, total assets increased 24.3% or 12 billion, when compared to that of the same period 2018, to reach 61.6 billion pesos, driven by the achieved growth in the consolidated loan portfolio and a wider base of funding sources. Outstanding debt totaled 41.5 billion pesos, up 35.5% or 10.9 billion pesos when compared to last year's, primarily attributed to the placement of the Senior Notes due 2027, the issuance of local notes and arrangement of different bank loans, including the IDB Invest credit line. Here, it is important to mention that given our success in international debt placements, solid-rock origination standards and a record-high collection in December, our cash levels surpass the 1 billion pesos mark; bringing forth a strong financial position to start year 2020. Last, but definitely not least, as of year-end, stockholders' equity totaled 16 billion pesos, an annual increase of almost 1% or 120 million pesos, following the already discussed factors and the cancellation of stock that we just mentioned earlier. With this, I conclude my remarks. And now let me turn back the call on the Operator to open the line for Q&A.

Operator: Thank you, sir. 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, *1 to ask your question now. Our first question comes from Ernesto Gabilondo with Bank of America.

Ernesto Gabilondo: Hi good morning, Carlos, thanks for the opportunity. I have a couple of questions. On the first one, you expect now that earnings should be meaningfully improving in 2020, as you mentioned you have improved your loan mix, you should start to see funding cost declining, and probably you should maintain OPEX and asset quality under control. So, can you elaborate on your expectations for MIN, cost of risk and OPEX growth in 2020. And then, for my second question, we have seen, you have been reducing your participation in Resuelve tu Deuda, so, how do we think about growth in net fees going forward? thank you.

Carlos Ochoa: Hello Ernesto, thank you for participating in the conference. When it comes to the net income to tell you the truth, we are optimistic. I mean, on the one hand, I mean, now we are viewing terms of terms of cost of fund, is that the work had past at and that happened in 2019 and, in that sense our review for the remaining of the year is that the, if the cost of funds at the end of the year remains in a range of 12.3 to 12.5, which seems something very attainable. That should be healthy, not in terms of the NIM to start trending upwards from the 17% to something closer to the 18%. So as long as the, as long as the NIM in general terms ranges above the 18% mark, I would say that I, I would say that in terms of net income, we could easily be surpassing whatever we did during this year**.** But if you think about the net income this year and excluding the non-recurring item, this was an extraordinarily good quarter, so we would expect in general terms to attain at least double-digit growths for the remaining of the year. Something definitely above the double-digit growth. That is our view in terms of the net income, I do not know if that answers your question.

Ernesto Gabilondo: Well, yes, and just in terms of OPEX and asset quality for getting these at being double-digit growths?

Carlos Ochoa: Yes. I mean, if you look at, one of the good things, I mean, a lot of people asked us, when you know, about the way we are growing the SMEs portfolio, however, one of the very good things about that one, not only comes from the growing part, but also in terms of the asset quality, especially because if you think about our business model, which relies heavily in cross-selling and on recurrent customers. And with higher average ticket size, that helped us a lot in terms of the cost of risk. So, our view in terms of the SMEs business is that we are not compromising profitability due to product mix, because a much lower cost of risk, that is definitely our review. We do not expect, you know, on the other hand, we do not expect changes in the asset quality, I mean, if the NPL remains something around the 1.5% range, we definitely will be satisfied at the end of the year. But that is definitely what we are doing. On the other hand, one of the things that we are trying to do for this year is that, if you think that, out of the total liabilities of the Company, only 5% or not even 5%, comes from development agencies. What we intend to do is to increase this portion of funding to at least for the 10%, and that should definitely have a positive effect on that, on the cost of funds overall. Having said that, I mean, similar to the IDB line, I mean, what we intend to do is increase the line with the NAFIN which has already been approved and moving forward in that regard. And that, you know, the combination of these new facilities would definitely help us to improve profitability for the SMEs business overall.

Ernesto Gabilondo: Okay, um, yes….

Carlos Ochoa: Yes? no, no, no, ask me…

Ernesto Gabilondo: So, just wondering, so, what you mentioned that there will be growth in SMEs, with good asset quality. So, although, with respect as you mentioned NPL remained stable, can we take the same for the cost of risk?

Carlos Ochoa: Yeah. I mean, if you look at where the cost of risk stands, I mean, at the 3.5, I mean that… sorry, I have the figure over here… at the 3% range, where for the year was the 2.8% mark, that is a very healthy cost of risk, I mean, our target would be, you know, our target these days is focusing heavily on collection and focusing heavily in terms of asset quality, and I think that the cost of risk should be stable, remain stable within these range. I mean, we feel comfortable with those figures, and we believe that is something that is sustainable.

Ernesto Gabilondo: Okay, perfect. And then you have my second question.

Carlos Ochoa: Yeah, when it comes to Resuelve, I mean, basically what we are doing, I mean, and that is something that we, that both Angel and I have talked to many of you in the past month. I mean, what the Company intends to do, you know, invest as if it was our last million, and by saying that is that we are focusing on protecting the NIM overall, and only in the most relevant and most productive assets that we have. So concurrent, um, consistent with that. Basically the, consistent with that, was the initiative, you know, to sell as small portion of the participation of the Resuelve, and as for what we would expect. I mean, given that we are not going to be consolidating anymore that one, in terms of the, the lines of commissions and fees collected which was mainly Resuelve, that, well for the next year is not going to be as relevant. It used to be something around the 100 million mark, a 100 million per quarter. That was what happened in the past. And probably it should remain something in more, something I do not know, 400 million probably, less for the full year. But in any case, we will be, you know, compensating that income in the other line.

Ernesto Gabilondo: Can you repeat again how much?

Carlos Ochoa: 100 million that was roughly, I mean, what we used to collect, what we used in the commissions and fees collected line on the per quarter was roughly 100 million per quarter.

Ernesto Gabilondo: And now?

Carlos Ochoa: Given that we are not going to be consolidate in Resuelve, you would not be seeing that figure again.

Ernesto Gabilondo: But you guided something around 30 million per quarter.

Carlos Ochoa: Excuse me?

Ernesto Gabilondo: **(**Inaudible)

Carlos Ochoa: No

Ernesto Gabilondo: Should we expect a?

Carlos Ochoa: Yeah, it is probably going to be something around the I do not know, it is going to be something around the 20 or something within that wage, is not material, I mean, because if you want to emphasize at this point that we did not rely on commissions or we did not charge commissions and things like that in most of the products over here in Mexico, where in other places, I mean, we might be charging something, and you know, small fees. So, that is probably the only thing that you will be seeing, something around, I do not know, probably 20 or 30 million pesos per quarter.

Ernesto Gabilondo: Perfect, understood. Thank you very much.

Carlos Ochoa: Thank you, Ernesto.

Operator: Thank you. Our next question from Carlos Rivera with Barclays.

Carlos Rivera: Hi, good morning everyone and thanks for the presentation. My first question is regarding the loan growth for this year. You shared your expectation of between 15 to 20. So, if you could give us a little more color here in terms of growth by segments, particularly the SMEs portion has been going pretty fast. And I remember from the Crédito Real Day in New York that you mentioned a target of about, between 15 to 20% of your portfolio there. I think you are already there, 16% in Mexico, 4% in the US. So, what are you thinking for each segment? and what are the implications for your funding needs of 2020? In particular, if you are thinking about any, bond issuance, in addition to increasing the lines from the development bank that you mentioned. That would be my first question and I will ask the second one after. Thank you.

Carlos Ochoa: Okay, hello Carlos. I mean, when it comes to the SMEs, Yes. I mean, what we liked a lot about the SMEs is the asset quality, you know, the improvement that we get in the cost of risk on the consolidated cost of risk, given that much larger average ticket size that we have on that business. So, like that, you know, by increasing the participation of the

SMEs, though somehow put some pressure on those, somehow it put some pressure on the yield. On the other hand, releases a lot in terms of the cost of risk. So that is what we like. However, I mean, what we see and consistent to what we said over there in the, in the Crédito Real day, while in New York. Yeah, it should remain something around the 15, probably to the 20%. But that is going to depend also in terms of the funding that we might get from the development agencies. I am sorry, I am listening a lot of noise on the line, operator, do you know?

Operator: Yes sir. That is coming from Mr. Rivera's background.

Carlos Ochoa: Okay. Going back to the, going back to the question, if at some point, we increase the funding from development agencies, that should help us in terms of growing the SMEs portfolio and also, to improve the profitability for those products. So that would be the only case, in which the SMEs business to grow above the 20% mark. But as I stated at the beginning, we do not see that happening, it is probably going to remain within this range of the 16-17% overall.

Carlos Rivera: Okay, and in terms of the indications for funding for 2020. Any color there?

Carlos Ochoa: Yes. I mean, what we intend to do is that, we intend to tap the Swiss market, we intend to tap the Swiss market next week, and if we are successful in that one, probably, we would not be needing any money for the first half of the, for the first half of the year. And as for the second half, it is going to depend on market conditions, definitely. And it is going to depend on whether we expect to do something on the liability management front. But at this point, we are focusing our efforts on the, we are focusing our efforts on the, on tapping the Swiss market next week.

Carlos Rivera: Okay, great. And my second question is going to be on the, again on the SMEs portfolio. In particular that you mentioned the low cost of risk there. If you could share with us your cost of risk for SMEs? I am just making sure, I mean, the NPL ratio there is pretty low 0.5%. It is even very low when compared to other peers that are focused on SMEs leasing. So just want to make sure that this low ratio is true to this level and is not distorted by any other stuff like the strong growth of the denominator on that ratio. Or make sure that, on the accounting inside that, Instacredit becomes overdue. If you are registering the full outstanding balance of a client, that becomes overdue as NPL or if it is only the portion that is overdue. So, I am just making sure, that the asset qualities are not distorted by any other factor, thank you.

Carlos Ochoa: Yeah, yeah, it makes sense your question, it makes sense a lot. I mean, first, I mean, you have to think about our business model. You know, how we started the business in the SMEs front, I mean, that was five years ago. And basically, the business model consisted in, you know, we relied on that relatively customer base, and it continues to be the case. I mean, if you look at the line of the, the number of customers that we have on the SMEs, are not even a thousand over there. So basically, we have a very reliable, we have, you know, a very recurrent customer base. It is about 75% of our customers are recurrent. So what we started to do in the last few, in the last couple of years with the leasing product, is adding new products, you know, in order to, you know, to increase the cross-selling opportunities to these same customer base. I mean, we saw a very attractive opportunity in the leasing business, to do some cross-selling, and something similar to that is with the factoring business, so that is basically what we have been doing. And also, when it comes to new customers, it is also important to mention that the approval rates are very low. The approval rate in that business here in, on the Mexico's front are something around 25% to 30%, not even 30%. And basically, what that translates into, is that we are cherry picking customers. So, we do not see, we do not see changes in terms of the asset quality. And when it comes to the NPL definitions that we use, not only for this product but for all the products, is consistent all across the board and it is consistent with the CNBV, with the Mexican regulator, meaning that, the NPL definition that we use all across the board is 90 to 180 days, and we charge it off at the 181 day and it amounts for the full loan. So basically, that is how it works. And when it comes to the provisioning, well, the provisioning it is based on expected losses, the provisioning are based on expected losses consistent with the CNBV requirements.

Carlos Rivera: Okay, and what is the number for that provisioning, for the portfolio.

Carlos Ochoa: What is? Excuse me?

Carlos Rivera: So, what is the level of loan loss provisions as a percentage of loans that is going on the SMEs portfolio? about…

Carlos Ochoa: I think I can give you the figure, give me a sec. I can give you the figure for that one, you have on the earnings release and that amounts for...that amounts for 80, close to 85 million as of the end of the quarter. And for the full year amounts for 130, about 130 million for the whole year.

Carlos Rivera: Okay, alright, great. Thank you very much, Carlos.

Carlos Ochoa: Thank you, Carlos.

Operator: Thank you. Our next question comes from Nicolas Riva with Bank of America.

Nicolas Riva: Yeah, thanks, Carlos for taking my question. Just, one question, (inaudible) as follow up on the prior question on liability management. If I look at it, specifically looking at some of your bonds. If I look at the 2023, they are trading basically to call in July of this year. You mentioned you are going to be looking to tap the Swiss market, next week. And with that probably done, in terms of new issuance, for the first half of this year. For the 2026s, you know, we have seen a lot of non-bank financials doing tender offer on some of these bonds and, issuing new, longer dated bonds. Does it make sense to think of you calling the 2023s in July and potentially doing a tender offer on the 2026s, and then on the (inaudible) I would put it, I would assume, that that one is only going to be calling 2022 given that it counts as equity for accounting purposes and, also partially as equity for the rating agencies. But what are your thoughts in terms of these bonds and in terms of liability management? Thanks.

Carlos Ochoa: I mean, we are limited in, when it comes to the liability management, if we think that for this year we will be focusing a lot in terms of profitability, when you have a bond trading at 1.17 such as the 2026, Well, you know, thinking about, you know, liability management for that one a sounds kind of expensive, right? So, in that sense, we might be thinking to do something about the 2023s or something. But that is not sure at this point. Basically, the view that we have when it comes to tapping the markets, either of the markets. Is more in terms of refinancing, rather in terms of issuing. So, basically what I am trying to say is that we feel comfortable, you know, if you look at the form that our debt profile is taking these days, if we feel comfortable, you know, by, you know, having 400 million outstanding facilities, and, not larger, not much larger than that, because we are thinking that is a much more cautious approach to, compared to what we did in the past. For example, the 625 million of the 2023s, that sounds, you know, complicated for refinancing these days. So, basically, that is going to be our view. But as for this year, you know, whatever we intend to do in terms of liability management is going to be limited, you know, for the, on the effects that that has on the P&L, basically.

Nicolas Riva: Alright. So, it is fair to say that the 2023s would be the priority for liability management this year.

Carlos Ochoa: Yes, most likely, most likely. However, well, I mean, we already did the liability management of those, a couple of months ago, so, yeah. In any case, I think that if something like that happens, that is going to be, you know, on the second half of this year, assuming that market conditions should prevail at the time.

Nicolas Riva: Thanks very much.

Carlos Ochoa: Thank you.

Operator: Thank you. Our next question comes from Natalia Zamora with GBM.

Natalia Zamora: Hi. Thank you for taking my questions. I have, two quick questions. How do you see the portfolio breakdown going forward? With SMEs being relevant within the consolidated portfolio, what do you expect the breakdown to look like in coming years? And, for my second question, at the beginning of the call, you mentioned the cancellation of shares, now that you cancelled that many shares. Do you expect to remain as active in terms of that effect? Thank you.

Carlos Ochoa: Hi. Yeah, well, when it comes to the breakdown of the consolidated portfolio, probably the most important, we have two elements, I mean, provision that could improve the NIM of the SMEs products could lead to increase the size of that one to probably maximum at 17% or probably something within that range, as we view. Probably the most interesting parts are going to be on the other front. For example, Central America, Instacredit was, Instacredit had an extraordinary year. It was an excellent year, especially when you compare it to the previous one, when the 2018 and what we intend to do is to continue, you know that same, to continue the trend for this year. So, if at some point the Instacredit business gains weight to become something around the 12% that is going to help us a lot in terms of profitability, and that is our view, and also to compensate whatever pressure we put on the NIM. So, the intention should be, you know, to growing healthy on the Instacredit business, to improve the NIM on the SMEs front. And when it comes to the States, it is also very important to mention, I mean, we finally are making money in the States, and it looks, you know, and it looks very promising the businesses over there. The SMEs continue to grow. I mean, we have, we have a really nice business model over there, targeting Latin owned business. And we are confident that that could, that at least not for this year, but at least, you know, over the next couple of years we will attain, we will attain our targets of the US becoming something around the 30% of the consolidated portfolio. Interestingly, as well, it is going to be the payroll portfolio, that my view is that it should remain something around the 60%. So basically, that is going to be how is (inaudible). You have all the lines of business, such as the used cars. But you cannot be very aggressive growing the used car business here in Mexico and something similar to what we do, you know, in the States. So, you know, overall, that would be, you know, that would be kind of the, of what we expect for the business, at least in the next couple of years. And overall, I think that, if you look at the growth trend, the consolidated growth trend, that we have been having over the past three years, yes, definitely growing 20%, growing 20% this year, is something, you know, doable, and that is, that is our target for this year. And now when it comes to the other one, I mean, if you think of what we intend to do in terms of the buyback and things like that, I mean, it is basically, stating how confident we are on the future of the Company, that is at the core of the buyback program of the Company. If you look at the figures that we especially, if you look at the resources devoted to the buyback, it has not been that material, it has been more on the, you know, market making front, but definitely, what we believe, our view over here, is that our stock is trading at a huge discount. And if there is something, we can make you know to enhance that valuation. Especially through the buyback front. Yes, we would continue to do it, but not without changing, you know without materially changing what we have done in the past couple of years.

Natalia Zamora: Okay, great, thank you. Very helpful.

Operator: Thank you, our next question comes from Gilberto Garcia with Barclays.

Gilberto Garcia: Hi good morning, thank you for the call. You had very strong growth in SMEs, during the quarter, record origination for any segment. Can you tell us, what drove this performance? was it that you are extending greater credit to existing customers, or was there any particular new customer with the high balances that drove this performance? Thank you.

Carlos Ochoa: It can be a mix of them, but in any case, I mean, it is you know, at the core, are the cross-selling opportunities for the, you know, for our customer base. That is at the core of the SMEs business. Yes, on point we have rather large operation, not very large, because if you think what limits the SMEs, is our cost of fund itself. I mean, if you look that for the past year, it was above the 13% mark. I mean, how much do you expect to charge? You know, when you have such a large, you know, when you have such a large cost of fund, so, that definitely limits the type of operations that we have, that we serve on the SMEs front, probably it is worth mentioning, you know, other than the cross-selling opportunities is the fact that we have no concentration whatsoever, the only concentrations that we have are geographically, and by geographically, I mean, you know, most of our customer they are in Mexico City or the surroundings, and a couple of cities outside. So, we have no concentration in terms of industries. We have no concentration, we have low exposure to federal agencies, or governments or strong support. So that is basically our business. And also, it is also important to mention the fact that we acknowledged, as I already mentioned, that SMEs business is going to remain something around the 15% to 20% at most. So basically, we are acknowledging that this is not going to become our core business. So by saying that and I what I want to be emphatic about this one is because we are not, you know, we are not constrained to continue to grow in that business, and it is just basically, you know, growing in the, you know, with the right, premium approach. And that is basically what we have been doing for the for the SMEs business… Did I answer your question?

Operator: Our next question comes from Natalia Corfield with J. P. Morgan.

Natalia Corfield: Hi, Carlos. My question is with regard to capitalization, I have seen that you have been, very excited about the growth in the SMEs portfolio. And you have been growing quite a lot, in the US 29%, next year seems that there is going to be a little bit of a deceleration of 15 to 20%. But I have been looking, your capitalization has been in decline now for a number of quarters. So, I am wondering, what are you thinking about that? And, if rating agencies have spoken to you about this? What are your main thoughts?

Carlos Ochoa: Hi Natalia. Well, first if you look at the breakdown of the equity, what happened this quarter, the most visible thing about the capitalization for this quarter comes from the hit that we took from the valuation of cash flow hedges. If you look at that figure, that amounts for 708 million and that is what put some pressure on the capitalization at least for this quarter. If you ask me, I mean, clearly this is associated to the strong peso that we are seeing, and especially when you see that most of the, most of the derivatives, I mean, that we have a very conservative approach in regard to the hedging and the effect that that conservative approach that we have on hedging is the pressure over the capitalization or over the equity. So, what I am saying is that, if at some point, I mean, I do not know what is your view on the FX for the end of the year, but we believe that for the end of the year, the FX should be about 20 pesos per dollar, that should release a lot of the pressure that we are seeing on the capitalization. So basically, what we are, what I am saying is that the pressure that you are seeing over the capitalization, is mostly attributed, not only to the growing in the, in higher (inaudible) in terms of capital products, such as the SMEs but it also comes from the FX front, that definitely there is not much that we can do on that end. So, what we would expect, I mean, something that we have been in very close touch with the rating agencies, clearly. Because we acknowledge that the, our rating, it is a key differentiator. So, in that regard, we are, you know, closely looking at the capitalization, and closing look at, you know, how to improve the capitalization and basically, the view that we have of protecting the NIM overall comes also on that end, you know, because the NIM reflects our capacity to generate equity. So that is what I can tell you that mostly, I mean, we were hurt for this quarter, we were hurt by, you know, by the strong peso here in Mexico.

Natalia Corfield: Okay, that is very clear. Thank you.

Carlos Ochoa: Thank you, Natalia.

Operator: Thank you. Our next question comes from Nick Dimitrov with Morgan Stanley Investments.

Nick Dimitrov: Hi, Carlos. Most of my questions have already been answered, but, if you do not mind, can you kind of compare and contrast your SMEs business in Mexico versus the one in the US? You know, you mention in Mexico, you do a lot of leasing and then there is some factoring, low approval rates, kind of, you know, low cost of risk. How does this relate to your US business?

Carlos Ochoa: I would say that the, you know, the biggest difference between the two of them are the average ticket size that is definitely for starters. I mean, if you think about our customer, our customer base over there in the States, or mostly, 93% of the customers are Mexican, in Spanish. I mean, they average ticket size is way, way lower. So the way to approach them, that means, you know, a typical customer over there, there could be, you know, someone in the food truck industry or something like that, in the case of the States, whereas over here, what we are doing is that, first of all, you have to think that the SMEs are, you know, largely underserved here in Mexico and for this customers, if you think in terms of average ticket size. I mean, for example, right now with the leasing product involved, they are in 500 thousand dollars range. If you think about someone trying to borrow that amount of money, over here, it has to rely on their on their own personal resources whereas in the States is different. So basically, that would be, you know, the main difference between the two businesses is, we are targeting different segments of the population. Over there, Hispanic, for the Latin owned business. Whereas over here are, you know, stable businesses paid taxes, and that have been on the business for a number of years, and that is basically what we do.

Nick Dimitrov: So, so it is fair to assume, that most of the SMEs lending that you are doing in the US is driven by leasing, right? Similar to that you went to Mexico.

Carlos Ochoa: In the US?

Nick Dimitrov: Yeah.

Carlos Ochoa: Into Mexico, not only that, but the thing about that, I mean, if you think about the three products that we that we group on the SMEs portfolio over here in Mexico, you have leasing, with duration on the average, is something around 48 to 50 months. Where from the other two cases of the credit, credit, the credit products here in Mexico are mostly for working capital needs, so in terms of duration, those are, I do not know, probably 6 to 12 months and that is something similar to what we have in the case of the factoring, I mean, in the case of the factoring is much smaller, it is something around 3 months or something like that. So basically, yes, when you think about the balance the outstanding, the standing balance in the SMEs business, largely is the SME, is the leasing. However, in terms of origination is not probably the case. I mean, given the difference, in the duration in the three products.

Nick Dimitrov: Understood. And just for one last question on funding, you know, for a while, you were saying that, you have converted your funding to primarily all fixed, right? think when we were in the rising (inaudible) environment. Rates are coming down in Mexico, I think you know, it is, what, 60% 60-40% floating. How do you want to manage it going forward?

Carlos Ochoa: Look, I mean, the, to tell you the truth. If you think about the, for example, the last transaction when we printed to the euro deal. We printed that one and we fixed that one, we fixed, those what? those 11.33 if I recall correctly. So basically, that is for 7-year duration or something like that. So basically, the interest rate, what I am saying, what I am trying to say, is that the interest rate cuts were already (inaudible) at the 11.33. So that was the assumption that we made at the time to fix it. Clearly, fixing the rate has another advantage, it reduces volatility both on the equity front as well as on the, it reduces volatility both on the equity front as well as on the P&L. So that is another advantage if you look at, the, for example, 708 million that I mentioned earlier, yes, a lot of that amounts for the unfixed part of the, the unfixed part of our liabilities. So it is going to be a mix of them, it is going to be a mix, but in any case, we will continue to profit, you know, on the most efficient cost of fund and without, you know, without the FX risk. That is basically the rationale behind this decision.

Nick Dimitrov: Ok, excellent, thank you.

Carlos Ochoa: Thank you, Nick.

Operator: Thank you again to ask a question, *1 at any time. Our next question comes from Gilberto Garcia with Barclays.

Gilberto Garcia: Hello, again. Apologies for before, I got disconnected. I have a follow up question on guidance, since you had a number of extraordinary items in the quarter and so, at the year, when you talk about double net income growths, are you referring to be reported net income growth or to be adjusted figure?

Carlos Ochoa: To be reported net income.

Gilberto Garcia: Okay. Thank you.

Carlos Ochoa: Thank you, Gilberto.

Operator: With no questions in queue the Q&A session concludes. I like to turn back to our speakers for closing comments.

Carlos Ochoa: Well, thank you, everyone.

Operator: Ladies and gentlemen. Thank you all for being in today's conference call. You may now disconnect and thank you for joining us this morning.

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