



Mexico's financial sector remains under pressure

Eurobonds of Mexico's largest non-bank financial services provider Credito Real remain under pressure.

After a short rebound following the publication of moderately weak 1Q21 financials and under the influence of technical support factors, bond prices dropped again, renewing local lows. The notes in our prop-portfolio (in EUR) fell almost 20% from their purchase price (current price of CREAL stands at 27-76.4%), to a low of November 11, 2020, following two sell-offs (poor second-quarter financials on the back of the pandemic). The 2020 annual report (published on the company's website in Spanish) triggered new investors' concerns, although the 2020 financials (including the recent increase in the amount of overdue debt) were released earlier.

NEW NEGATIVE FACTORS ALREADY PRICED IN?

- **The news was that the company disclosed the breakdown of the loan portfolio, splitting it into a “core” part and accrued interest on loans (allegedly accounting for 45% of the total portfolio). Accumulated interest of this amount is atypical of the business model used by Credito Real and could indicate hidden overdue debt.**
- On the negative side, the company disclosed the share of borrowers in the SME division (the 10 largest loans in its small- and medium-sized portfolio were 17.4% of the total debts outstanding). **To add to the woes, these facts were mentioned in the note released by an analyst of one of the well-known American investment companies, that seems to short the notes. Unfortunately, Credito Real failed to promptly provide further explanation and disclose additional details regarding portfolio composition.**
- Although investors' attitude toward Credito Real's securities have deteriorated significantly in recent weeks, we still believe the situation is far from critical (potential default) and prices will eventually recover to pre-selloffs levels.

\$, mln	1Q21	2020	9M20	2019	2018
Assets	3879	3 542	3356	3262	2520
Cash	21	55	18	62	29
Equity	865	814	807	851	810
Loan Portfolio	2608	2397	2202	2487	1847
Total Debt	2859	2504	2368	2200	
Net profit	5	38	30	103	102
ROAA	0.5%	0.6%	1.1%	3.6%	4.3%
NIM	10.4%	11.5%	11.8%	17.1%	20.8%
NPL ratio, %	3.9	3.3	1.8	1.3	1.7
Coverage ratio	117%	225%	217%	220%	173%
Equity/Assets	22%	23%	24%	26%	32%

Source: Company data, ITI Capital

DOWNGRADE BY S&P, BUT OUTLOOK STABLE

- S&P expectedly reacted to the news about the company by cutting its rating by one notch to BB-. However, S&P kept “stable” the outlook. The agency's analysts are concerned with the continuing deterioration of the asset quality, which will lead it to raise loan-loss reserves and, consequently, will negatively affect profitability and capitalization of the company. At the same time, the assessment of capitalization remains at an "adequate" level. S&P believes in the gradual recovery of Credito Real credit metrics, and appreciates the level of liquidity of the company (including through access to financing in international markets). Among other positive news, we can also highlight the recent successful refinancing of a number of credit lines (for over 1 billion pesos, including \$100 mln from Wells Fargo).
- The issuer, for its part, maintains an ongoing dialogue with the investment community, publishing regular updates regarding important credit developments and conducting unscheduled calls with investors to reassure the market.

BOTTOM LINE

- We continue to view the recent events as market overreaction and expect the situation to gradually normalize, as we monitor the latest news on a daily basis.

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