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INVESTOR UPDATE

JUNE, 2021

CRÉDITO REAL (CREAL)

PLEASE SEE IMPORTANT DISCLOSURES & COPYRIGHT INFRINGEMENT IN THE APPENDIX

EXECUTIVE SUMMARY

Crédito Real (CREAL) is a leading financial institution in Mexico, with presence in the United States, Costa Rica, Panama, Nicaragua and Honduras. The Company's focus is consumer lending with a diversified business platform. CREAL's target market is low and middle-income segments of the population that have historically been underserved by other financial institutions.

We recommend the 2026 Credito Real US-denominated global bond at Strong Underperform/Underweight. This investment is most suitable for investors with a high risk tolerance and should expect continued short-term volatility in the Bond's price due to deterioration in earnings quality and concerns around the Company's financial recovery.

COMPANY OVERVIEW

Crédito Real (CREAL) is a leading financial institution in Mexico, with presence in the United States, Costa Rica, Panama, Nicaragua and Honduras. The Company's focus is consumer lending with a diversified business platform in the following main lines of business: payroll loans; small business loans; used car loans; consumer loans through Instacredit and group loans. CREAL's target market is low and middle-income segments of the population that have historically been underserved by other financial institutions.

FINANCIAL PERFORMANCE (MEXICAN PESOS) – THREE MONTHS ENDED MARCH 31, 2021

Profitability

Credito Real reported net revenues of Ps. 1.08B for the first three months of 2021, down 13.0% or Ps. 160.8M year-over-year. Interest income rose 4.2% to Ps. 2.80B while interest expense rose 38.8% to Ps. 1.50B, resulting in a financial margin (net interest income) of Ps. 1.31B, a 19.0% decline year-over-year. The net interest margin stood at 10.4%, down from 13.4% a year prior.

Total income amounted to Ps. 3.08B, up from Ps. 2.80B in the previous year period, with the payroll segment generating 44.2% of total income, followed by SMEs at 22.9%, Personal at 21.6%, Used Cars at 9.7%, and Other business at 1.6%.

The increase in interest income was driven by an improved performance in the Payroll segment, fuelled by the acquisition of a payroll loan portfolio from Banco Ahorro Famsa in early January. There was also a decrease in relief programmes as a percentage of CREAL's total portfolio.

CREAL's average cost of funds stood at 11.2%, up 180 basis points from the comparable period of 2020. This increase was driven by a Ps. 112.1M impact related to the negative carry associated with unused proceeds of the Senior Notes due 2028, and to a lesser extent, higher debt costs due to new funding agreements in comparison with old issuances, which have mitigated the impact of the lower interest rate environment on the Company's floating rate debt.

Credito booked Ps. 490.0M in net provision for loan losses, a 6.5% increase year-over-year. Allowances for loans losses as a percentage of the total loan portfolio stood at 3.8%, up from 3.7% a year prior and represented 117.5% of the total past-due loan portfolio, down from 219.1% year prior. This movement was driven by a better performance in the international businesses and a Ps. 205.6M gain from the recovery of charge-off accounts in 1Q21 versus Ps. 118.7M in 1Q20, which partially offset additional provisions booked for the SMEs segment to manage potential COVID-19 related impacts. Provisioning for the Used Cars and Personal segments fell 42.8% and 67.5%, respectively, while rising 223.7% and 157.9% for the Payroll and SME segments.

Commissions and fees paid amounted to Ps. 79.4M, up 23.47% year-over-year. Commissions and fees paid reflect commissions paid for debt issuances. Intermediation costs of Ps. 26.1M were booked for the first quarter, relative to income of Ps. 61.3M in the prior year period. Intermediation income represents the result and valuation of derivative financial instruments.

Administrative, promotional and depreciation expenses rose 30.8% or Ps. 237.9M to Ps. 1.01B. This increase was attributed to a Ps. 115.8M increase in depreciation expenses, the issuance of the Senior Notes due 2028 in January 2021 (Ps. 71.6M) and expenses incurred to boost the reactivation of the business. The increase in operating expenses resulted in an efficiency ratio of 62.5%, up from 49.9% in 1Q20. As such, the operating profit for the period amounted to Ps. 67.1M, down 85.6% year-over-year.

Net income amounted to Ps. 89.4M (or US$4.4M), down 70.7% or Ps. 216.0M year-over-year, despite a 90.2% decline in income taxes to Ps. 12.5M, which led to the effective tax rate falling from 27.4% in 1Q20 to 18.6% in 1Q21. Return on assets stood at 0.5% while return on equity stood at 2.1%, compared to 1.8% and 6.9%, respectively in 1Q20, reflecting the sharp decline in net profit.

Solvency & Liquidity

Credito's total assets amounted to Ps. 77.15B at the end of the first quarter, up 5.7% or Ps. 4.18B from its balance a year earlier, driven by loan portfolio expansion, an increase in fixed assets, and a higher cash and investment securities balance following the issuance of CREAL's Senior Notes due 2028 in January 2021.

Investment securities rose 503.9% or Ps. 4.36B to Ps. 5.23B, driven by the unused proceeds of the issuance of the Senior Notes due 2028, which should provide the company with the liquidity to service the expected incremental growth in loan demand as well as meet prevailing and emerging challenges related to the current economic environment.

Property, furniture & fixtures rose 411.3% or Ps. 2.68B to Ps. 3.33B, while there was a 4.4% or Ps. 2.20B increase in the total loan portfolio to Ps. 51.86B. The increases in these line items were partially offset by a 69.4% or Ps. 5.16B decline in securities and derivatives transactions to Ps. 2.27B and a 78.4% or Ps. 1.50B decline in cash and cash equivalents to Ps. 414.6M.
The chart below displays the breakdown of CREAL's portfolio. Payroll loans remained the largest segment of the loan book, with its share increasing to 58.1% of the total portfolio. Net loans amounted to Ps. 49. 47B, up 3.1%, with the non-performing portfolio amounting to Ps. 2.04B, a 166.0% increase year-over-year.

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SUMMARY OF OPERATIONS											
	1Q21					1Q20					
	Portfolio (millions of pesos)	%	Customers	NPL	Average loan (Pesos)	Portfolio (millions of pesos)	%	Customers	NPL	Average loan (Pesos)	Var. Portfolio (%)
Payroll	31,768.0	58.1%	471,487	1.7%	67,378	28,432.7	57.1%	442,569	1.1%	64,245	11.7
SME	12,519.3	22.9%	3,544	12.0%	3,532,525	10,703.4	21.5%	3,307	0.5%	3,236,595	17
Used Cars	4,073.0	7.4%	23,931	1.5%	170,198	4,050.5	8.1%	23,149	1.8%	174,974	0.6
Personal	5,160.8	9.4%	155,321	4.2%	33,227	5,993.1	12.0%	171,268	4.7%	34,992	-13.9
Other	1,184.6	2.2%	348,430	4.0%	3,400	647.2	1.3%	267,496	4.3%	2,420	83
Total	**54,705.70**	**100%**	**1,002,713**	**3.9%**	**54,558**	**49,826.9**	**100.0%**	**907,789**	**1.5%**	**54,888**	**9.8**

Source: CREAL 1Q20 Earnings Release

The non-performing loan portfolio represented 3.9% of total loans as at March 31, 2020, up from 1.5% a year prior, and 3.3% from the 2020 year-end. The sharp increase in bad debt was attributed to the impact of the ongoing COVID-19 outbreak has had on CREAL's clients, which has resulted in a decline in collection levels. CREAL noted that a non-performing customer in the SME segment significantly impacted the NPL ratio, and excluding this effect would have resulted in an NPL ratio of 2.6%.

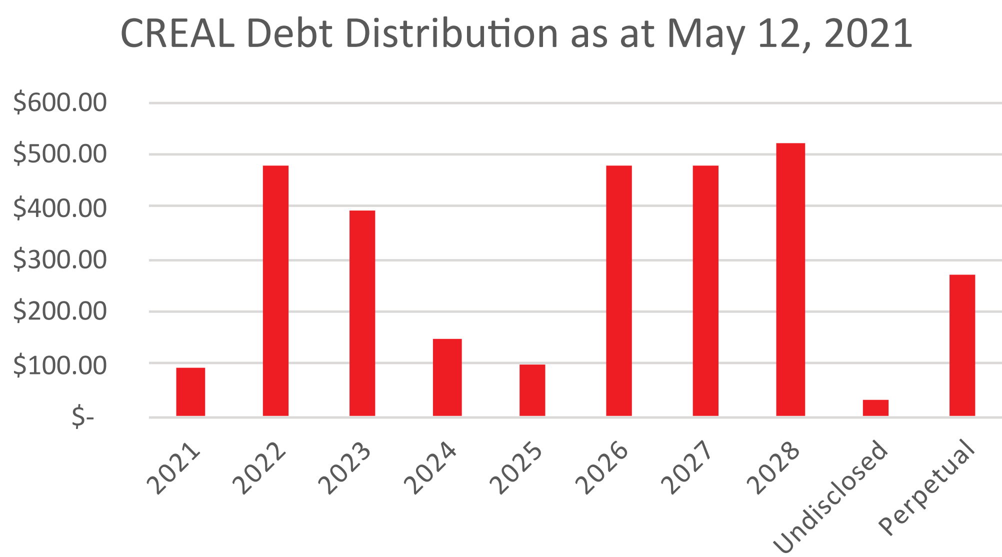
The percentage of CREAL's portfolio supported by relief programmes has trended downwards over the last three quarters, falling to 2.0% in 1Q21, down from 6.3% in 3Q20 and 5.2% in 4Q20. However, Collections amounted to Ps. 7.81B for 1Q21, down from Ps. 8.19B in 1Q20 and Ps. 8.3B in 4Q20. One would expect collections to increase as relief programmes trend downwards but this movement may be attributable to the increase in the NPL ratio from 1.8% in 3Q20, 3.3% in 4Q20 and 3.9% in 1Q21.

Other accounts receivable amounted to Ps. 8.58B, up 17.1% year-over-year. This line item consists mainly of income paid in advance to payroll distributors and the joint-risk responsibility in accordance with commercial agreements. Foreclosures assed surged 5,302.0% or Ps. 1.31B to Ps. 1.34B, which represents assets received in lieu of payment upon calling on loan guarantees, which is in line with the increase in non-performing loans. The company expects to liquidate these assets within the year. Other assets amounted to Ps. 5.22B, down 4.8% year-over-year.

Total liabilities amounted to Ps. 59.95B, an 11.4% or Ps. 6.12B increase year-over-year. The weighted average duration of liabilities was 3.5 years, compared to a weighted average duration of assets of 1.5 years. Total debt amounted to Ps. 56.86B, up 11.8% year-over-year, as senior notes rose 8.3% to Ps. 33.86B while bank loans rose 18.4% to Ps. 21.83B.

Unsecured debt represented 79% of debt, with 60% of all debt denominated in USD, followed by 20% in Mexican Pesos, 14% in Euros, 6% in Swiss Francs and 1% in Nuevo Sol – the currency of Peru. The Company hedges exchange rate volatility utilizing derivatives. Approximately 88.5% of foreign currency debt is hedged mainly by derivatives (mainly cross currency swaps) with the remaining debt naturally hedged by the international businesses which generate foreign exchange. The chart below displays CREAL's debt distribution as at May 12, 2021. The Company has just US$91.23M in principal and interest currently due in 2021 with debt obligations rising to US$478.53M in 2022.

The weighted average fixed coupon rate is 7.22% while the weighted average tenor is 4.04%. Total debt amounted to US$2.98B, up from the US$2.78B reported at the end of 1Q21.



The company has enjoyed strong support from banks and global capital markets when it has sought to raise funding, as evidenced by a successful debt raise in January 2021, when the company issued US$500M in Senior Notes due 2028, with a coupon of 8.0% per annum. The Company also closed a credit line for US$100M with a 7-year term with the U.S. International Development Finance Corporation in the same month. Subsequent to the quarter close, its US-based near-prime auto-lending subsidiary raised US$130M in notes through an asset-backed security (ABS) structure in April 2021.

The Company also renewed a US$50M credit facility with BNP Paribas on April 22nd. On May 10, 2021, the company announced the successful renewal of two credit lines with BBVA and Mifel, which follows the successfully renewal of two credit facilities with MULTIVA and Santander at the end of April. The four renewals together amounted to over Ps. 1.0B. The credit terms (principal, maturity and rate) were unchanged, which reflected the respective creditors‘ confidence in the Company.

Shareholders’ equity amounted to Ps. 17.20B, a 10.1% decrease year-over-year. This movement was driven by a 116.8% fall in “valuation of cash flow hedges” from positive Ps. 937.9M to negative Ps. 157.3M. Accumulated results from prior years amounted to Ps. 10.23B, up 3.4% year-over-year. The debt-to-equity ratio rose to 3.3x, up from 2.7x a year prior. The capitalization ratio moved from 38.5% in 1Q20 to 31.4% in 1Q21.

Bad Debt Revision

The company raised alarms across global capital markets on April 26, 2021 when it was revealed that the Company had restated the size of its non-performing loan portfolio at the end of 2020 in its 2020 annual report by US$36M, or 82% higher than what was reported in its original fourth quarter filing. The news of the bad debt revision caused the Senior Notes due 2026 to fall 6.08 cents to 90.58 cents on the dollar on April 27, 2021.

Investors were already on high alert after rival Alphacredit acknowledged accounting errors in its derivatives position that required it to revise its 2018 and 2019 financial statements on April 21, 2021. These errors led to the booking of an impairment of a majority of the US$206M reported as other assets and accounts receivable in its Sept. 30, 2020 balance sheet.

On a teleconference call with investors for the first quarter 2021 results, CREAL management raised more concerns than they addressed as they did not explain how one customer could have been granted a such large loan in the first place nor give colour on the number of large loans in the SME segment. The existence of such a large loan raised concerns about concentration risk in CREAL's SME portfolio.

Coming out of the teleconference call, CREAL promised to address disclosure concerns and issued a special report to provide further details on its NPL ratio and the composition of the SME portfolio.

The chart above displays the top 10 loans in CREAL's SME Mexican portfolio, with the largest amounting to Ps. 695M (approximately US$35M) and representing 6.3% of the SME portfolio. This loan is significantly larger than the other loans in this segment, as the second largest loan stands at just 37% of the size of the largest loan. The average loan size in the SME Mexican portfolio as March 2021 was Ps. 16.2M or US$803K with a non-performing loan ratio of 14%.

While it was not explicitly stated which loan was revised to a bad debt, the fact that the largest loan amounts to roughly the same amount of the revision, it is logical to assume that this loan, the company's largest in the SME segment was the same loan that the Company's auditors required be reclassified as non-performing.

Credit Rating

On May 13, 2021, S&P Global Ratings lowered its long-term global scale issuer credit rating on Credito Real to "BB-" from "BB". The issue-level rating on the company's senior unsecured notes to "BB-" from "BB" while the outlook is stable. The downgrade reflects lower-than-expected year-end 2020 and first-quarter 2021 results and the expectation of "very difficult conditions" for the coming months. S&P noted that several of the company's financial metrics eroded due to Mexico's deep economic contraction, which resulted in low origination, higher funding costs, and a jump in delinquencies.

The rating agency expected the company to gradually recover and restore loan growth and profitability levels. However, disappointing first-quarter results have "hobbled the recovery, weakening our risk-adjusted capital ratio, asset quality indicators, and profitability metrics for the next twelve months". S&P noted that in addition to the deterioration of CREAL's profitability in 2020, the expectation of the impact on the CREAL's capital base from the financial developments disclosed by the company during the first quarter of 2021, have also prompted S&P to revise its assessment of the company's capital and earnings to a weaker category.

S&P further stated that with COVID-19 lingering in Mexico and Central America, the economic recovery will depend on the vaccination pace and efforts to reduce the contagion. S&P does however, view favourably CREAL's strategy to decrease its SME exposure to around 15% of its total loan portfolio, from 23% currently and narrow its focus on the payroll segment. However, the timeline and success of this strategy could take longer than expected to materializewhile also being reliant on external market conditions.

S&P's liquidity assessment reflects its expectation that CREAL will maintain relatively stable collection levels despite the sluggish economic recovery. They believe that payment collection will remain a significant source of liquidity for CREAL and noted that CREAL has the flexibility to slow down its loan origination to

[2] *Capitalization ratio – stockholders' equity/total portfolio*

improve liquidity through loan repayments. However, a drastic fall in collection under severe stress conditions or the lack of renewal of credit facilities could hamper it liquidity.

COMPANY OVERVIEW

Economic Outlook

The Mexican economy contracted by 8.2% in 2020, the largest annual contraction since the 1930s as economic activity was hard hit by the COVID-19 pandemic. The second quarter bore the brunt of the disruptions caused by the pandemic as real GDP contracted 18.7% during the period. A sharp increase in infection rates towards the end of 2020 led to renewed commercial restrictions in Mexico City before Christmas, which handicapped the recovery in the first quarter as the coronavirus death rate hit record levels.

New cases peaked towards the end of January 2020, with over 20,000 cases being reported daily. Deaths also peaked in the first month of the year, averaging over 1,000 per day well into the second week of February 2021. Real GDP was estimated to have contracted by 3.8% in the first quarter as a result. Mexico's central bank (Banxico) improved its forecast for economic expansion on March 3, 2021, increasing its GDP forecast from 3.3% (made three months prior) to 4.8%. This compares to an IMF estimate of 5.0% growth for 2021 and a Bloomberg contributor composite estimate of 4.7%.

In December 2020, S&P Global Ratings affirmed Mexico's "BBB" foreign currency and "BBB+" local currency long-term ratings and held its outlook on the sovereign at Negative. S&P noted that despite a "pronounced hit" on the economy in 2020 and the expectation for a slow recovery, the government continues to pursue cautious countercyclical fiscal and monetary policies. The ratings reflect the admission that Mexico's democracy has brought political stability and regular changes of government over the last two decades but has not created economic dynamism compared with other emerging markets or improved public security.

The COVID-19 pandemic and oil price shocks have only served to exacerbate Mexico's already modest growth. As such, subpar recovery is expected for 2021 with real per capita GDP growth to remain below peers of a similar level of economic development. The number of vaccines doses secured by Mexico as at May 12, 2021 through current agreements was over 230 million, which covers over 100% of the population. As of May 11, 2021, Mexico has administered 18.47 million vaccine doses, and has fully vaccinated just 6.18% of the population.

Analyst Opinion

The CREAL 9.5% 2026 bond currently trades at a price $89.79 with a yield to maturity of 12.41%. From the relative value chart, we see that towards the end of April, the yield to maturity on the Senior Notes due 2026 surged from below 8.0% on April 20, 2021 to over 12.0% by April 27, 2021, as the news broke that the Company had revised its non-performing loan portfolio, almost doubling of the NPL ratio.

The announcement roiled the market for CREAL securities as the bond yield rose to levels just below those seen in late-March 2020 during the global asset free-fall surrounding concerns around the COVID-19 pandemic while the shares of the company listed on Mexican Stock Exchange have fallen to their lowest levels since listing.

CREAL's financial performance was severely hampered by curtailment measures enacted to stem the transmission of the COVID-19 virus but the Company was still able to eke out a marginal profit for both the 2020FY and 1Q21. The company's liquidity was adequate at the end of the first quarter as cash and investment in securities amounted to Ps. 5.6B or US$282M, which eclipses the US$90M in principal and interest currently due in 2021.

The company has instituted an action plan which consists of: safeguarding the well-being of employees and key operating metrics; prioritize asset quality over growth; strengthening the cash balance and liquidity position; and enhancing capitalization by limiting share buybacks and postponing dividend payments. The company reiterated its goal to limit the expansion of its loan portfolio and enhancing liquidity which is supported by cash and investment securities amounting to Ps. 5.64B at the end of 1Q21, up 103% year-over-year, and compares to an average of Ps. 2.63B over the prior four quarters.

Despite these moves, we like other analysts globally are concerned about the appropriateness of the company's risk management protocols as one loan had the ability to materially deteriorate CREAL's NPL ratio. When questioned, management did not engender confidence as to how such a large loan was granted. The concern now is that one or more large loans could fall into default and cause the NPL ratio to increase further. The company has sought to allay such fears by highlighting that outside of its two largest loans, all other loans in the SME segment represent 1% or less of the total SME portfolio.

RECOMMENDATION

As such, we are downgrading our rating of the Credito Real due 2026 US-denominated global bond to Strong Underperform/Underweight. We expect the company to be able to cover its short-term debt obligations and believe the company still enjoys funding access as evidenced by the renewals of over PS 1.0B in financing between the end of April and mid-May 2021. However, the recent news has increased volatility in the trading of CREAL's securities and we anticipate that this volatility will persist in the short-term until the company is able to consistently produce improved financials.

Based on the factors discussed above, we believe this Bond is suitable only for investors with a high-risk tolerance and we would recommend that investors limit their allocation to reflect the high level of risk associated with this investment.

Source: http://www.jamstockex.com, JMMB Investment & Research, Bloomberg, Company Financial Statements, Fitch Ratings, S&P Global Ratings, International Monetary Fund World Economic Outlook

APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT— As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation DEFINITIONS/ RECOMMENDATIONS.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

UNDERWEIGHT -
REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

SELL -
REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

HOLD/MARKET WEIGHT -
EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

OVERWEIGHT/BUY -
EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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