Bladex

FOURTH QUARTER 2022 EARNINGS CALL

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Participants:

- Jorge Salas, Chief Executive Officer
- Ana de Méndez, Chief Financial Officer
- Samuel Canineu, Chief Commercial Officer
- Carlos Raad, Head of Investor Relations

Carlos Raad:

Good morning everyone, and thanks for joining our fourth quarter 2022 earnings call. Before we begin our presentation, allow me to remind you that certain statements made during the course of this discussion may constitute forward-looking statements, which are based on management's current expectations and beliefs, and are subject to a number of risks and uncertainties that could cause actual results to materially differ, including factors that may be beyond the company's control.

For a description of this risk, please refer to our filings with the US Securities and Exchange Commission, and our earnings release. Speaking today's call is our CEO, Jorge Salas, and our CFO, Ana de Mendez. Also joining us today are some of my colleagues from the executive team that will be available for the Q&A. With this, let me turn the call to Jorge. Please go ahead.

Jorge Salas:

Gracias, Carlos. Hello everyone and thank you for joining. Today, we will discuss our fourth quarter results and take the opportunity to summarize the progress on the execution of our first year of our five-year strategic plan. Let me start by reviewing the highlights of 2022, and then I will turn the call to Ani, our CFO, who will explain the fourth quarter results in detail. Finally, I'll make some closing comments related to the outlook for 2023, how we're navigating the current environment, and provide some guidance.

Let me go straight to slide three, please. Amid geopolitical tensions, record high inflation, and a global slowdown, Bladex delivered very strong results. In 2022, we managed to grow our loan book as much as 18% during the year, increase our margins, and maintain a very robust asset quality. Our NII was up 71% year-on-year, net interest margin increased almost 40 basis points. In fees, both syndication and letter of credit fees were up 8% year-on-year.

The results: Net income for the year is almost 50% higher than last year. Return equity is almost 300 basis points higher than last year. And perhaps more importantly, the trend as we will see now is very positive.

Behind these results, there is a renewed management team that is carefully executing a well-thought-out strategy designed to capitalize the strong upside potential of our unique business model while taking advantage of the current macro scenario.

Economic activity in Latin America exceeded our expectations and remained resilient last year. The region grew almost 4% and foreign trade flows reached record high. The anticipated and decisive action of Latin American central banks, our class A shareholders, allowed a gradual absorption of global shocks. There is no doubt that the economic activity in the region together with tight credit markets and high commodity prices had a positive impact on Bladex's performance. Having said that, the main drivers of the solid financial results for 2022 were largely the product of the execution of our strategic plan.

Moving to slide four, let me give you a brief update on the progress of our strategic plan. As I mentioned during our investor day in November, Bladex has a clear opportunity to increase its profitability without changing the essence of its business model. Optimizing capital allocation, increasing cross sales with fee generating products, automating key processes, expanding our client deposit base and growing our customer base without changing our credit risk appetite are some of the avenues for growth in the plan.

Our renewed commercial team now headed by Sam Canineu has been able to expand our client base by 29% thus far. All of our new clients have the same risk profile of our current client base top tier corporations in the region. Furthermore, 42% of the average growth in 2022 came precisely from clients that were added during the year.

The commercial team was also able to capitalize on our single point of contact model and managed to increase product penetration by 15%. That is 15% of our customer base has now at least one additional product. Moreover, we were able to increase our corporate deposit base, which together with a fixed rate medium term funding that the bank has been securing since 2020 have been key to mitigate the impact of interest rate hikes on our cost of funds.

All of this was possible not only because we added new bankers in key markets. It was possible because we also streamlined our new client onboarding processes, reducing new onboarding time by 43%, and also redesigned our key operational procedures to reduce inefficiency allowing for additional transactional volume which has increased already 30% over the last year.

I'm going to leave it here for now and turn the call to Ani, our CFO, who will walk you through our fourth quarter results in detail. Ani.

Ana de Méndez:

Thanks Jorge. Good morning everyone. I am pleased to present our quarterly and annual results starting on slide five with a $31 million profit for the fourth quarter of 2022, reaching a total of $92 million for the year, denoting a 47% annual increase. In turn, annualized quarterly ROE has also been increasing, reaching a level of 11.6% in the fourth quarter, positioning the bank for sustained two digit ROE. Actual ROE for the year 2022 reached close to 9%, up by 284 basis points from the previous year.

In the next few slides, I will give you more color on the main drivers sustaining the positive trend that flow to the power bottom line and increased profitability.

Turning to slide six, total asset increased by 15% on an annual basis to $9.3 billion on the back of strong 18% growth in the loan portfolio reaching $6.8 billion at year-end, including another $0.9 billion in contingencies, mainly consisting of the issues and confirmation of letters of credit, Bladex's commercial portfolio closed at $7.7 billion and 18% increase from the previous year.

This strong growth in Bladex's core business reflects its focus on enhancing cross-selling and expanding the customer base while taking advantage of the macro environment in LATAM with increased economic and trade flows activity. The bank's commercial business is complemented by an investment portfolio allowing for further diversification of exposures by country with a balance of over $1 billion at year ends. In addition, the bank's cash and due from banks mostly placed with the New York Federal Reserve stood at 13% of total assets at year-end, following a prudent liquidity management under Basel III standards as required by Panama's banking regulator.

Turning to slide seven, you can see the high turnover of our commercial portfolio with maturities exceeding 60% of the total during the quarter, and disbursement for a similar amount, allowing us to quickly pick up the trend in higher lending spreads, which we continue to experience for several quarters now as we continue to focus on margin expansion through optimization of portfolio mix and risk adjusted returns. Hence, the average lending spread over the market base rate, which is mostly software for the fourth quarter stood at 2.81%, denoting a 66 basis points increase from a year ago. The average duration of the portfolio remains short at close to 12 months with 72% maturing within the next year.

As shown in slide number eight, our funding structure stayed well diversified. Deposits have historically represented an important and resilient source of funding throughout economic cycles while also being the most cost-effective one. As of December 31st, 2022 deposits represented 40% of total funding, 45% of which came from our central bank plus A shareholders, another 39% from our client banks and corporations, and the remaining 16% relate to our Yankeees CD program. Apart from deposit, Bladex's funding comes from several sources across the globe, including ample availability of bilateral credit lines from a wide range of correspondent banks and the continuous access to the debt capital markets as well as the global syndicated loan market.

Turning to slide nine, Bladex remains well capitalized, reaching a Basel III tier one ratio of 15.3% and the Panamanian regulator's capital adequacy ratio of 13.2% at year-end. During 2022, Bladex achieved a more efficient use of capital, having increased its loan portfolio at higher margins and returns. As we commented on our last quarterly call, we saw a deceleration in loan growth during the fourth quarter, having favored margin expansion of our balance sheet growth while remaining committed to a sound capital position, a pillar of our business model. In addition, the board recently declared a dividend of 25 cents per share for the quarter, unchanged from preceding quarters, and representing a payout of 29% of four quarter earning.

Turning now to slide 10, we present the continued positive trends in net interest margin and spread, driving strong top line performance. Net interest spread representing the rate differential between interest earning assets and financial liabilities reached 1.63% in the fourth quarter of '22, an increase of 20 basis points from the previous quarter and of 37 basis points from a year ago, mainly on account of increased lending spread. In turn, net interest margin representing the yield of interest earning assets, including the portion financed by the bank's equity reached 2.11% in 4Q '22, an increase of 34 basis points from the previous quarter and of 69 basis points year-on-year supported by both higher netting to spread and by the impact of increasing market rate on the overall yield of assets financed by the bank's equity.

Moving on to slide 11, we can see that the overall impact of rate increases on assets and liabilities supported by higher lending spreads and market rates, as I just stated, was the reason behind about half of the $61 million increase in net interest income for the year 2022. The other half is attributed to strong average credit growth, mainly on the loan portfolio, which increased by over $1.4 billion or 28% when compared to the year before, complemented by another $536 million growth in average credit investment portfolio accompanied by the related increase in financial liabilities and a continued prudent and proactive liquidity management.

On slide 12, fee income from letters of credit have shown an increasing quarterly trend throughout 2022, resulting in a total of $14 million for the year, representing a 16% annual increase from the previous year. The other important component of fee generation for the bank relates to the structuring and syndication business. Given its transaction based nature, its activity should be analyzed annually rather than on a quarterly basis. So for the year 2022, it also showed stronger results, increasing by 15% to a level close to $5 million.

As shown on slide 13, Bladex maintains sound asset quality levels. Low risk stage one exposure accounted for 98% of the total credit portfolio at $8.5 billion at year-end. Accounting for another 1.7% were credits classified as stage two for a total of $147 million, representing closely monitored credits which have experienced increased risk since origination but are still performing.

Finally, stage three or impaired credit represent merely 0.4% of total exposure for a total of $35 million at year-end 2022, as we classified new credit for a total of $25 million as impaired during the fourth quarter. Overall, total reserve coverage is about two times the balance of impaired credit. Total credit provision charges for 2022 amounted to $19.5 million related to increased individually allocated allowances to stage three credits, as well as to an increase of stage one collective reserves on credit portfolio growth during 2022.

On slide 14, we can see a positive trend in the bank's efficiency, as solid revenue growth has consistently overcompensated higher expenses by design. For the year 2022, the cost-to-income efficiency ratio stood at 33% compared to 38% in the previous two years. With a focus on strengthening Bladex's execution capabilities, expense increases mainly reflect a higher salary base on new hires and a new performance based variable compensation structure, along with other expenses related to strategic initiatives to improve processes and technology.

Let me leave it here and turn the call back to Jorge for his final remarks. Thank you.

Jorge Salas:

Thank you very much Ani. The macro-economic and the financial outlook for Latin America is far from being settled in balance. We see 2023 as a year of transition, transition towards lower growth, transition towards lower interest rates, and transition towards a slightly lower inflation rate, but still above the target.

Clearly inflation is likely to be more persistent than many expected not so long ago. The space and timing for turning point in interest rate is the big question mark. Our expectation is that this will happen towards the end of 2023.

Key for the region and for Bladex is the fact that foreign trade flows that are currently at record levels will grow an additional 2%, reaching almost $3 trillion by the end of 2023. That is 37% higher than pre-pandemic 2019 levels. There is no doubt that the surge in commodity prices exacerbated by the Russian invasion of Ukraine is the main driver of this positive trade shock for Latin America and particularly for South America. Having said that, while commodity price increases are favorable, clearly mediocre GDP growth and high inflation is not favorable for the region. In this context, during 2023 we will focus more on profitability and less on growth.

Moving on to slide 17, let me mention a few words on management focus for the year. Unlike last year that we grew 18%, in 2023 we aim at single digit growth 3% to 4% consistent with a macro trend. We plan to maintain discipline credit underwriting standards as the current high interest rate environment poses clear risks, particularly for over-leverage companies, especially if we couple that with a demand shock.

Thirdly, as Ani mentioned earlier, we see a positive trend in margins going forward. The bank is currently positioned as a asset sensitive in anticipation of additional interest rate heights. Moreover, our frontline and our treasury units are focused not only in optimizing risk reward lending spread, but also making sure that we keep growing our deposit base, which is clearly our most cost-efficient funding source.

Lastly, we are convinced that we need to keep making progress on process redesign and automation and enhancing our product offering. As I mentioned before, changes made in key processes are already yielding good results. We're working hard to complement our product offering with treasury and structured trade and working capital solutions. This will not only strengthen client relationship but also favor our profitability going forward.

Moving on to the last slide, slide 18, let me share some guidance for the year. We expect core equity ratios to be strengthened. We are forecasting a range between 15% and 16% as our growth will be moderate and even more profitable than last year. We expect our net interest margin for this year to be above 2022 levels, between 2.1 and 2.4. Net interest margin for Q4 stood at 2.1% and that figure still does not incorporate the full impact of higher market rates.

Fees will continue to grow between 8% and 10%, mostly from letters of credit but also from our syndication desk. Our efficiency target will be around 2022 levels. That means 33% as we expect that higher revenues will continue to offset investments and process improvements and technology.

Last but not least, our return on equity will likely be on the low double digits, in line with the longer term guidance that we shared during the Investor Day last November. By the way, the full webcast is available in the IRS section of our website. I'm going to leave it here for now and open the call for questions. Operator.

Operator:

Thank you very much for the presentation. We'll now be moving to the Q&A part of the call. If you have a question, please press star two on your keypad. That's star two on your keypad. You may also ask a voice or a text question if you are dialed in via the web. We'll now give a minute or so for the questions to come in.

Okay. We'll start with the first text question from Patrick Brown. First of all, excellent results and congratulations. I have two questions. My first question is: Given the recent supply chain disruptions, and particularly with China, there's a lot of talk that Mexico has benefited from nearshoring. What are you seeing on the ground? Has this represented any opportunities for Bladex? And then the second question. Revenue growth during 2022 has helped to compensate the material increase in expenses, but part of this revenue growth is due to markets. How are you preparing the bank for potentially lower market scenario to sustain current cost-to-income ratio?

Jorge Salas:

Thank you, Mr. Brown for your question. Let me start tackling the second question first. As we have mentioned, the main objective, our strategic plan is to make sure that the bank has sustainable returns. As we stated on Investor Day, the target is mid-teens returns by 2026, and we're clearly on track as you can see. Bladex share of wallet with most clients is improving, but there's still clearly a big upside ahead, but our product offering is also limited, and as I said, we're working hard on that. We are developing new products that will generate additional spreads and fees, and that will compensate for sure for a potential decrease in rates. This includes scaling our letter of credit business, project finance fees, revenues from treasury products, expanding our deposit base. That will for sure compensate a decreasing rate. As we make progress and the bank gain scale, we will for sure maintain our efficiency and potentially improve it.

I have to say, having said all this, that we do not see pre-pandemic interest rate levels in the near future, for sure not at 0% that was when everything started.

In regards to the second question about nearshoring, short answer is yes, we are starting to see some business opportunities that we believe are the result of the first phases of nearshoring. Particularly in Mexico, we're seeing companies developing industrial parks mainly in the automotive and telecommunications. As a matter of fact, I saw today an announcement that Tesla is considering opening a manufacturing production in Mexico. Nearshoring for sure will strongly benefit the large LATAM conglomerates that are clients, most of are clients of us. Many of those clients are asking for capital for their investments. So the short answer is yes, this should ultimately lead to increased trade flows between the US and Mexico, and that's the core of our business, so inevitably will benefit Bladex in the long run.

Operator:

Okay, thank you very much for that answer. Our next question comes from Mr. Ricardo Vallarino, individual investor. You commented on the Investor Day that you set a target size for a commercial portfolio of $10 to $11 billion for the year 2026. Recently, you have commented that you expect portfolio growth to slow down to 2023. Can you give us a roadmap on how you see Bladex reaching the Investor Day target?

Jorge Salas:

Yes. Thank you. Thank you for your question. The pace of our growth is dependent in large part because of the dynamics of the region. So we grew more than expected the first year and then we're slowing down a little bit this year basically because of the headwinds in the economics of the region that we're seeing now. So the $10 billion to $11 billion target on our commercial portfolio is we're way on track and the pace, again, the pace of the growth will depend largely in the dynamics of the region, but also to the extent that we have additional products and a larger customer base as we are getting now.

Operator:

Okay, thank you very much for that answer. The next question is also a text question. This is from Mr. Jeffrey Otto from Jeffrey Otto CPA. Congratulations on your fourth quarter and full year 2022 results. I had high expectations and you have exceeded them. I do have a concern about your NPLs. In the fourth quarter, they grew from 11 million to 35 million with the bank largely involved in trade finance. Generally short term I would like to have some color on this. Is this result of the bank's changing lending criteria, a mistake in oversight on the company industry or country lending activity? Is this a level we should expect to see with the volume in the bank is doing?

Jorge Salas:

Hi. Thank you for your question. First of all, credit underwriting standards have not changed and will not change. We will remain very conservative. We did have an uptick on NPL and it's mainly due to one exposure in particular. It's a non-banking financial institution in Mexico that represents less than 0.3% of our loan book, and it's largely reserved by the end of 2022. We have materially increased the coverage after that company announced Chapter 11 in Mexico last November.

So we're really not concerned about our exposures in non-bank financial institutions. That is one-off case in Mexico and our non-bank financial institutions do not represent more than 3% of our portfolio, and it's mainly regulated companies or affiliates of financial institutions, and it's mainly in Chile. So we are not concerned and not changing our credit risk capital.

Operator:

Okay, thank you very much. Our next question comes from Andrea Atuesta from Bancolombia. Hello. Thank you for the opportunity to ask a question. I would like to have more color about what you are expecting in NIM and profitability in the rates begin to decrease, but the expenses are stable. What will the strategy to maintain solid margins be?

Jorge Salas:

Let me turn that call to ... that question to Ani. Do you want to comment on rates?

Ana de Méndez:

Sure. Thank you. Yes, our expectation, Jorge mentioned with respect to the NIM, what we see is we still have to see all the repricing of interest rate increases in our assets and liabilities. So in the very short term, we expect net interest margin to continue expanding, Jorge mentioned between 2.2%, 2.4%. That depends on future Fed actions and the repricing that we see in our balance sheet.

After rate increases come to a stop, like Jorge just mentioned in the previous answer, we are in the process of developing new structured products and tailor-based solutions that will enhance spreads, and that's precisely what our five-year plan is about. So we do expect that to be able to compensate rate increases. And also as Jorge mentioned, we do not anticipate that interest rates are going to go back to 0% that we saw at the beginning of the pandemic, so more normalized interest rates of around 2.5%, 3% say the Fed fund rates should remain constant.

So in our projections for our retarget of meeting, that is definitely contemplated. So margin expansion, new fee generating products, and interest rates that in a normalized level should be about 2.5%.

Jorge Salas:

I think Sam, our Chief Commercial Officer wants to say a few word about that too.

Samuel Canineu:

Yeah. I'd just like to reinforce that even though might not be so noticeable within the numbers, but a big part of the increasing profitability that we face, we've been facing quarter after quarter comes from, well, I would say this new layer of business that Bladex has been building that is a core part of our new strategy that comes from, if you heard, our Investor Day to the various types of arbitrage that we've been doing, both in terms of clients financing different countries, as well as all the structured trade finance part, supply chain finance, receivable discounts, and who did this. And that layer of business have been increasing quarter after quarter, and that comes with a higher margin. Same as new clients that we've been onboarding, and I think you have the numbers for last year, we did increase that substantially, and we continue to build that new layer of business and to build more optionality with everything that we do.

So we're not dependent on let's say the legacy business, or the business business as usual that we always been doing. I think that is building well, and I think we're right on course with the plan that we presented last year. Thank you.

Operator:

Okay. Thank you very much. We have a follow-up question from Andrea. How do you expect commissions and fees to behave in 2023 for syndication and letter of credit business? What is your expectation of growth on this front?

Samuel Canineu:

Those two business, because they are very different in nature. The letters of credit business again is part of the strategy that we've been doing. First of all, adding new clients that are specifically doing more this type of business. So a lot of the clients that we onboarded last year, they were clients specifically for the letter of credit business, as well as we've been focusing on cross-selling letters of credit business to clients that are only doing lending and we've been more and more successful on that. So I think the direction for that business in particular is to continue to grow.

Of course, we depend on the market. Letter of credit is very tied to trade in the region, and if the trade flows reduce, of course the business suffers, but that should be compensated new or more clients that we are adding both in existing clients in terms of cross sale as well as new clients.

So for the syndication business, that is a completely different business, and that is a business that it's really to grow the business more substantially it takes time. Bladex, we have a quite strong captive base of investors that come along with us in the most transactions that we do, but we're also very careful on what we sell to the market. So it's a business that we have not been more aggressive. We continue to do as we did in the past, creating solutions to clients that are willing to pay an extra fee for us to fundraise for them. That also is a business type two M&A activity when they require certain funds, and we do, I mean the market has been slower this year.

What we added that is new is the project finance business that should also generated more structuring fees. So I expect this year to be very much in line with last year, hopefully looking to increase the number because we think we can increase the number, but we depend on market conditions for the syndication business.

Operator:

Okay. Thank you very much. Our next question comes from Michael Rockman from GBR Consulting. How is the management and the board of directors thinking about capital allocation with dividend being more than three times covered and the stock at a substantial discount to book value?

Jorge Salas:

Thank you for your question, Michael. Capital allocation dividends and all the alternative, I mean including buybacks, potential hybrid instruments, that's an ongoing discussion at the board level.

We just reported a 15.3 common equity tier one ratio, which is at the lower end of the range that we have established. We want to operate the bank with ranges between 15 and 16. As I mentioned, we are committed to a sound capital position. It's a pillar of our business model and it's a pillar of our investment grade rating. I can say we're focused on optimizing the bank's capital allocation to support the growth of our long-term five-year plan that will take the bank to between $10 and $11 billion commercial portfolio. So we're focused on the long-term target more than the short-term.

Operator:

Okay. Thank you very much. I'm seeing no further questions at this point. I'll now be passing the line back to the management team for the concluding remarks.

Jorge Salas:

No, I just want to thank your questions and everybody for joining this call. As I mentioned before, we see 2023 as a year of transition in the region. We are committed to profitability and perhaps not so aggressive growth this year. Underwriting standards will not change and we'll focus on profitability going forward. That's what I have to say for now, and thank you everybody for connecting.

Operator:

Thank you very much. This concludes today's conference call. We'll now be closing all the lines. Thank you and have a great day. Goodbye.