Bladex

Q2 2023 EARNINGS CALL

Date: 21.7.2023

Participants:

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

Operator:
Good morning ladies and gentlemen and welcome to Bladex's second quarter 2023 earnings conference call. A slide presentation is accompanying today's webcast and is also available on the investor section of the company's website www.bladex.com. There'll be an opportunity for you to ask questions at the end of today's presentation. Please note today's conference call is being recorded. As a reminder, all participants will be in listen-only mode. I would now like to turn the call over to Mr. Carlos Rad, the Investor Relations Officer. Please go ahead sir.

Carlos Raad, CIRO
Good morning everyone and thanks for joining our second quarter 2023 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 U.S. Securities and Exchange Commission and our earnings release. Speaking on today's call is our CEO, Jorge Salas, and our CFO, Ana Mendes. 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, CEO
Thank you, Carlos, and good morning everyone joining us today.

I'm excited to share our second quarter results. I'll start by presenting the highlights of our performance for the quarter and then Ani, our CFO, will discuss the results in detail. After that, I will comment on our views on the economic dynamics of the region for the second half of the year, and then, as always, we will open the call for questions.

Moving to the next slide, slide two. Bladex had another outstanding quarter. All relevant financial metrics keep showing a positive trend as we continue to execute our strategic plan. Both our treasury unit and our renewed commercial unit had a very strong performance. The results speak for themselves. Once again, we're showing record net interest income for the quarter, $54 million in NII for the quarter, slightly higher than last quarter and 67% higher than the same period a year ago. Similarly, net interest margins stood at 2.42%, 88 basis points higher year on year. All this has been possible largely because we have been gradually and strategically reconfiguring our assets and our liability mix. On the asset side, the client-country mix has been optimized as well as new client onboarding remains strong across every geography we operate. This is very much aligned with our commercial team now having a higher weight on their railroad goals, on their scorecards, under the new variable compensation scheme. Similarly, on the liability side, deposits, our most cost-efficient funding source, have been steadily gaining share of the funding mix. Deposits as of quarter end were over $4 billion for the first time in Bladex's history. This represents almost $900 million or 30% growth year to date. But perhaps more importantly is the fact that they now represent 49% of total funding as opposed to 42% a year ago. And we expect this trend to continue going forward. Also, on the funding side, our treasury unit successfully issued medium-term debt in Panama for the first time ever and most recently in the Mexican market. Both issuances were supported by a very robust demand and after the diversification of our funding sources. Ana will comment on this in her section.

Also, I want to highlight another record-breaking result, fee income. Fee income was up 35% quarter on quarter and 38% year to date. This is mainly driven by our letters of credit fees, which as a trade bank is, of course, at the core of our business model. We have reached over $1 billion in letters of credit for the first time ever. Again, process redesign and increased operational capacity have enabled us to keep growing this business steadily. Bottom line for the quarter was $37.1 million for a return on equity of 13.4%, similar to the previous quarter and in line with our 2023 guidance and our long-term guidance of attaining a sustainable mid-team returns by 2026. These results are a clear reflection that Black has reached an inflection point as we keep gaining traction in the execution of our strategic plan, a comprehensive plan designed to capitalize on the very clear upside potential of our unique business model that is being carefully executed by our renewed management team.

I'm going to leave it there and turn the call to Annie.

Ana Graciela de Méndez, CFO
Thank you, Jorge, and good morning to everyone.

I would like to start with the quarterly evolution of net income for the last year on slide three, where we continue to see a solid trend with a 61% annual increase in quarterly profits reaching $37.1

million for the second quarter of this year, similar to the preceding quarter's level and resulting in a 13.4% ROE.

These strong results continue to be driven by the sustained improvement in top-line revenue, given a positive trend in the commercial business evolution, continuing to focus in new client onboarding and cross-sell, driving higher diversification and positive lending spread evolution. In addition, higher market interest rates continue to positively impact NII.

Let me now walk you through our balance sheet and profit and loss line items to better explain these results.

Turning to slide four, total assets reached an all-time high of over $10 billion at quarter end, representing a 14% annual increase on the back of increased loan and investment portfolio balances and a sound liquidity position.

The commercial portfolio, which includes loans and off-balance sheet letters of credits and guarantees, also reached record levels, totaling $8.1 billion at the end of the second quarter, up 7% from last year and 4% from the preceding quarter.

The growth of the commercial portfolio was driven in part by the incorporation of new clients, mainly in the corporate sector, and by cross-sell efforts, both part of the initial optimization phase of our strategic plan. The portfolio remains well-diversified across countries, having sized business opportunities in our top country exposures such as Brazil, Mexico, Colombia, Peru, and several Central American and Caribbean countries. In terms of products, letter of credit business remains strong and vendor finance, which is closely related to short-term commodity trade financing, proves resilience as the commodity cycle recedes, mainly maintaining good traction.

The short-term nature of the portfolio generates high turnover, with over 60% maturing quarterly and an average duration of close to 12 months, with 72% maturing within the next year.

The bank's lending business is complemented by an investment securities portfolio, allowing for further risk diversification, as almost 70% is placed with non-LATAM issuers, mostly from the U.S. This portfolio reached over $1 billion at quarter end and is fully comprised of securities held to maturity and accounted for at amortized cost, with an average remaining tenure of less than two and a half years. 75% of this portfolio is invested with investment-grade issuers, with an average rating of BBB- for the total portfolio.

The bank's cash position, mostly placed in the New York Federal Reserve, stood at 18% of total assets and 45% of deposits at quarter end, denoting a proactive and prudent liquidity management, which follows Basel methodology's liquidity coverage ratio.

Now let's move on to slide five, where we see our funding sources that remain well diversified across products, geographies, and tenors.

As Jorge mentioned, we continue to see an increase in deposits, reaching a record level of over $4 billion. As part of our cross-sell strategy from our client banks and corporations, together with our Yankee CD program, which continues to show a strong performance and provides granularity to our funding base. Deposits from our Class A shareholders, who place a share of their international reserves with Bladex, continue to have a relevant participation in the total deposit mix. Overall, deposit growth enhances atomization and continues to represent a stable and cost-effective source of funding.

We continue to have ample availability of bilateral credit lines from many corresponding banks worldwide, as well as constant access to debt capital markets and the global syndicated loan market.

During the second quarter, as Jorge also pointed out, we tapped for the first time ever the Panamanian debt capital market, having registered a corporate bond revolving program for up to $300 million in the local exchange, with an outstanding balance currently at $66 million. Along with other short and long-term private placements totaling over $160 million under our Euro medium-term note program. More recently, at the beginning of July, we successfully issued debt for a total of $4 billion Mexican pesos, or $238 million equivalent in the Mexican debt capital market, with three and five-year maturity tranches at a very competitive price when swapped to U.S. dollars.

Turning to slide six, we remain committed to a sound capital position, a pillar of our business model, which supports our investment grade ratings. Capital levels continue to increase on the account of solid quarterly earnings, resulting in improved capital ratios in line with our internal targets and risk appetite.

The board recently declared a dividend of 25 cents per share, an amount unchanged from preceding quarters.

Now turning to slide seven, we continue to see a positive trend in financial margins, driving strong top-line performance. Net interest margin reached 2.42% in the second quarter of 2023, up by 88 basis points from last year, and remaining relatively stable from the preceding quarter. On one side, higher weighted average asset rates have improved the return of equity funding such assets. On the other side, the average asset and liability rate differential, or net interest spread, has also expanded over the last year. This, in turn, reflects a positive evolution in lending spreads, as well as a proactive management of the interest rate gap in an increasing interest rate environment.

As a result, net interest income, or NII, presented on slide eight, has shown a strong growth over the last year. NII has increased by 83%, or close to 49 million dollars, when comparing the net interest income for the first six months of 2023 with the same period of the year before. Out of that total, 22.5 million dollars relate to an increase of 72 basis points in lending spreads over market-based rates, such as Fremont Software, for instance, while another 19 million dollars is attributable to the effect of high returns on the share of the balance sheet funded by equity, as

weighted average asset base rates have increased by 366 basis points to an average of 4.40% during the first half of the year.

Also, the bank has benefited from a base rate differential created by a slightly asset-sensitive repricing gap, adding another five million dollars to the NII variation. The remaining two million dollar increase in NII is mostly explained by the net effect of higher volumes and a change in asset and liability mix.

The impact of higher market interest rates accounts for over 40 basis points in the net interest margin for the first half of 2023, when compared to the same period of last year. On a pro-forma basis, assuming terminal rates of around 3 to 3.5%, the net interest margin would decrease by an estimated 15 basis points from the current 2.42% level. We expect this to happen progressively over the course of the next couple of years, a period during which we expect to see the results of various initiatives contemplated in our strategic plan that will more than offset the impact of lower market rates in our NII. Among those, it is worth mentioning the enhanced lending spread from structured products in trade finance, continued accretion of corporate clients and increased share in medium-term lending, both on our participation in our syndicated loans and project finance deals, as well as lower funding costs from higher corporate deposit base. Additionally, we expect increased non-interest income from letters of credit, syndications, and the deployment of treasury products, which will further complement revenue levels.

So, moving on to slide nine, fee income from letters of credit continue to perform well, as well as, I'm sorry, as we have seen greater activity both in balance and transaction volumes, as well as cross-sale and acquisition of new clients.

Together with fees from structuring and syndications business and other fees mostly related to guarantees, total fees for the second quarter of 2023 have increased by 52% over the last year. We expect the LCs business to continue showing a strong performance and foresee a pickup in syndication activity in the second half of the year, as we have a pipeline of transactions that should bear results.

As shown on slide 10, asset quality remains robust, with 98% of total credit portfolio categorized as low risk under stage one as defined by IFRS 9.

Accounting for another 2% were credits classified as stage two for a total of $205 million, consisting of closely monitored credits, which have experienced increased risk since origination, but are currently all performing.

Finally, stage three or impaired credits decreased to 0.1% of total exposure, and now amount to $10 million, having written off a deteriorated credit exposure in the non-bank financial sector, which was previously fully reserved. Overall, total reserve coverage is close to five times the balance of impaired credits.

Credit provision charges for the first quarter of 2023 amounted to $4.7 million, mostly related to portfolio growth and to a lesser extent to increase stage two and three reserves.

On slide eleven, we continue to see a positive trend in the bank's efficiency, maintaining a cost-to-income level of around 27% for the second quarter of 23, as a result of solid revenue growth and the close cost control. Having increased the bank's salary base over the last year on new hires, congruent with our focus on strengthening Bladex's execution capabilities as delineated in our strategic plan.

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

Gracias, Annie.

As we move into the second half of 2023, we anticipate a more challenging environment for the region. We project a slowdown in Latin America's growth to 1.6% this year, after the remarkable 4% we all witnessed in 2022. But there are both upside and downside risks to our growth forecast for the region. On the upside, we see potential in the surge of foreign direct investment observed towards the end of 2022 and the early part of this year. This has proven to be more sustainable than we initially expected and that will keep representing for sure lending opportunities for Bladex.

Additionally, resilient flows of remittances coupled with historically low levels of Hispanic unemployment in the U.S. provide further upside potential for growth. On the downside, as commodity prices recede from their 2022 peak, their contribution to the overall GDP growth in many countries has been weakening in recent months. This decline in export earnings, driven primarily by prices rather than volume, is a result of the decrease in global commodity flows. Considering these factors, our growth projections and monetary policy outlook already account for some modest currency weakening in the late 2023 and in 2024, supported by the recent easing in inflation that sets the stage for rate cuts in the region in the second half of this year.

I want to emphasize that we remain confident in our ability to navigate these conditions successfully and keep taking advantage of the opportunities that constantly arise in this volatile region. Once again, our strategic plan remains on track. We are pleased with the progress and execution thus far and we are convinced that the bank is well positioned to fulfill the guidance for this year.

Lastly, I want to recognize our new investor relations team that has made significant progress in fostering robust relationships with the investment community. They not only put together our inaugural investor day last year but have also proactively engaged with investors in all major regional investor conferences. Moreover, after years without formal coverage, DAIC now has three sales site analysts covering our stock, which of course increases the value for our growing shareholder base. Before opening the call for questions, I want to express my appreciation to our team, our clients, our shareholders, and our bondholders for their ongoing support and trust. We remain committed to drive long-term value for all of you. I'm going to leave it there and open the call for questions now.

Operator.

Q&A Section of the Call

Please stand by that the operator is having some problems. We will be back in a couple of minutes. Thank you.

Hi, I'm Carlos from IR. I'm going to take the first question from Inigo Vega from Jeffries. It's a written question.

Question 1:
Íñigo Vega, Jefferies

Fees from letter of credits are very impressive in the quarter. Can volumes grow further from here before tapping into new channels like FinTech?

Jorge Salas, CEO:
That's a good question, Inigo. The truth is that the ability to grow this business is more a function of the capacity to process than anything else. This quarter was indeed very good for our letters of credit business. It's important to know, though, that besides the growth from the existing clients that have accelerated via the cross-sell weight goals on the bond scorecards of our frontline, there were a couple of specific one-off opportunities in this quarter. We will, and it's an essential part of our business, there is an important project to automate and digitalize this process to keep growing this business further, and we expect additional volumes and fees going forward.

The second question comes from Patrick Brown, an individual investor.
Question 2:
Patrick Brown, Individual Investor

Can you remind us your need sensitivity for 100 basis points change in rates? How much time it takes for your assets and liabilities to fully reprice for higher rates?

Jorge Salas, CEO
Good question. So, for every 100 points movement in interest rates, there is an impact of about 12 basis points on our net interest market. This, of course, varies quarter for quarter because, as Annie always says, we have a very short-term duration on our portfolio, but that's our best estimate. Our balance sheet structure is you have obviously cash maturing, you know, immediate repricing, then you have obviously the loan portfolio, and then you have a longer duration on our investment portfolio that averages two and a half years. So, net interest margin should remain between 2.2% and 2.4% during 2023. That's our best estimate, and most likely on the upper range considering the recent results. This is, of course, subject to whatever the Fed decides to do on rates.

Thank you, Jorge.

Question 3:
Andrea Atuesta, Bancolombia

Next question comes from Andrea Tuesta from Bancolombia. Can you give us more details on what caused the loss on the financial instruments line?

Annie, do you want to take that?

Ana Graciela Mendez, CFO:
Sure. Thank you, Andrea. So, there are two main effects in the loss of financial instruments for this quarter. About half of it results from the temporary ineffectiveness of the bank's hedges. As you know, the bank does not run into any currency mismatches, and we don't maintain any trading positions, so we contract very simple derivative transactions to hedge the currency or interest rate risk arising mainly from our bond issuances in the capital markets. So, these hedges are perfect to maturity. However, due to the accounting norm, they require to be accounted for at fair value, and even though at maturity one will completely upset the other, at different moments in time, the fair values of the underlying debt and the hedge may fluctuate and result in either negative or positive effects, and that was the case in this quarter. The remaining effect relates to the sale of, and that's about the other half, of investment securities at amortized costs, giving increased risk that we saw at the beginning of the quarter, and this is aligned to our risk management policies with respect to this portfolio. Thank you, Annie.

The next question comes from Gilberto Garcia from Barclays. It's a live question, so I'm going to open the line for him. Gilberto?

Question 4:
Gilberto Garcia, Barclays

Hi. Hi. Good morning, and thank you for the call. I had a couple of questions. First, on your NIM guidance, it implies a bit of potential pressure pressure in the second half of the year. What would drive this pressure on NIM? And another subject, on dividends, given the rather consistent positive trends of the past quarters, would you consider increasing your dividend in the near to medium term? Thank you.

Jorge Salas, CEO
Okay, thank you, Gilberto. I'm going to take the dividends question first, and then I'll hand it over to Sam to talk about the net interest margin. So, as I always say, dividends is a quarterly decision, and it's up to the board. And I can tell you that discussions at the board level, not only on dividends, but in general, capital management alternatives, including not only dividends, but also even potential additional buybacks is a permanent discussion. I would stress, however, that we have shared short-term guidance and also longer-term guidance for 2026, and part of that

guidance is to manage capital ratios between 15% and 16% in our target portfolio between $10 billion and $11 billion. So, whatever we do on capital management will fall within those ranges. But ultimately, it's at the board level, and I cannot comment more than what I just said.
Samuel, do you want to? Yeah.

Samuel Canineu, CCO
So, this is Samuel Canineu, the Chief Commercial Officer. On the margins, speaking about the low margins, the margins on our commercial portfolio, I would say that up to now, we were able to consistently increase our margins, as it could be noticed in the, well, I think it's probably the seventh or eighth consecutive quarter. But we feel that we're getting to a cap in terms of how we can increase margins with existing and new clients, of course, bound by our own credit appetite. I think it's been clear that we're not going to change our credit appetite, and we feel that we have reached close to the limit, of course, by increasing, for example, we have not increased substantially the medium-term portfolio that can help us to increase margins because we saw better opportunities in terms of risk return on the short term. But that can change, so that can help to increase. But we feel that going forward, based on the activity of this quarter, we see that it's easing out a little bit, and that's why we haven't changed the guidance. Of course, there are other components of the NIM, such as the base differential between assets and liabilities, and that one, it really depends on the Fed action. If the Fed continues to increase, of course, then we can keep that differential or even increase a little bit that would have a positive impact on our NIM, but it really depends on the Fed action. But yeah, that's why I think the reason behind not changing the guidance.

Thank you, Sam.
Next question comes from Inigo Vega from Jefferies.

Question 5:
Íñigo Vega, Jefferies
What is the Stage 3 exposure you wrote off in the quarter? Any recovery potential on that particular ticket? Thanks.

Jorge Salas, CEO
Thank you, Inigo. So we're talking about the non-bank financial institution in Mexico. It's Unifin. Our exposure there was a total of $25 million, $20 on the syndicated loan and $5 on the bonds, and it was 0.3% of our total portfolio, and it was completely written off during the quarter. We are not very optimistic on any recovery there.

Closing remarks:

So I think that was the last question. So thank you, everybody, for connecting, and stay safe. Thank you very much. Goodbye.