Verum rates Navistar Financial as ‘BBB+/M’ and ‘2/M’

Monterrey, Nuevo Leon (September 24, 2018): Today, Verum awarded a long-term counterparty risk rating of ‘BBB+/M’ and a short-term counterparty risk rating of ‘2/M’ to Navistar Financial S.A. de C.V., SOFOM, E.R. (NF). Additionally, Verum rates ‘2/M’ the Short-Term Bond Program in an amount which is being extended from MX$1,800’000,000.00 up to MX$3,000’000,000.00 or its equivalent in Mexico's Investment Units (UDIs); this is a revolving program with maturity date in February 2022. The long-term rating perspective is “Stable”.

The ratings awarded to NF are based on the SOFOM’s proven business model, its financial performance, which has been good and consistent through different economic cycles, as well as the improvements observed in the asset quality metrics with a favorable tendency in the credit risk hedge and in its delinquency level. Additionally, this finance company has maintained good capitalization indicators, with a prudent growth strategy, which allows it to maintain such asset strength. Moreover, the concentrations in the portfolio by economic sector or group are still increased and its fundings basis is grouped in lines of wholesale credit with portfolio pledge but diversified by type of financial institution.

The ratings also take into account the existing strong synergies of the operational and commercial aspects, as well as of the use of the brand International, with Navistar International Corp. (“NIC”), ultimately its holding company, which is recovering from a complicated period in its operation and might demand resources if necessary. However, NIC has never required resources from NF and it provides support to NF through a committed line of credit fully available (through Navistar Financial Corporation [NFC]); such line of credit represents a significant strength to comply with NF’s short-term financial commitments.

As of the closing of 2017, with the gradual recovery of the transport sector, the loan portfolio (including lease operations) has experienced a significant increase of 11.0% in comparison to the closing of 2016, amounting to MX$14.573 billion, which is in line with the objectives set by the Management and with the expansion experienced in the truck and tractor-truck industry during the same period.

Verum considers that the strategic objectives of the financial institution are clear and feasible. The company, being a captive finance institution (of the brand International) intends to maintain the same credit products and does not expect any significant change in its business mix. Additionally, it is expected that the sale volumes within the segment of new trucks and tractor-trucks in the Mexican market for the next two years are maintained at similar levels or with a slight improvement in comparison to 2017, with the brand International keeping a share in such market between 20% and 25%. Additionally, we consider that NF will continue to fund around 50% of the total sales.

The non-performing portfolio indicator has been maintained at reasonable levels for the segment to which the SOFOM provides services, being of 2.4% in June 2018; furthermore, in the last four years, this indicator has been maintained at appropriate levels, ranging from 2.0% to 3.7%. This has mainly derived from the deep knowledge that the SOFOM has about its target market and because NF has been conservative and selective in the granting of loans and leases after the strengthening of its origination parameters. As for the allowance hedge of non-performing portfolio, it continues at good levels and with a tendency to grow, representing 1.4x respect of them (2017: 1.3x; 2016: 1.1x). We expect that the finance company continues to set aside an allowance of at least 100% for its non-performing portfolio, based on the implementation of a conservative preventive policy in its loan allowances, as the company has been doing since its beginning.

Due to the nature of the retail financing transactions, such transactions have no significant concentrations in the company’s portfolio. However, the wholesale loans continue to have an important role in the portfolio structure, as well as in the shareholder's equity. Therefore, as of the closing of 2Q18, the main 10 borrowers represent 38.1% of the total portfolio and 1.4 times (x) the assets (including a related loan, which is its main debtor: 12.5% and 0.4 x, respectively).

The NF profitability has proved to be stable and recurrent through the time, since it is benefited from moderate but consistent margins, as well as from an outstanding operational efficiency. The net profit during the first quarter in 2018 was MX$194 million (fiscal year 2017: MX$483 million), showing asset profitability indicators and average equity of 2.5% and 11.7%, respectively, which are appropriate levels in the opinion of Verum and they are in line with the company's historical average (2014 - 2017: 2.7% and 14.4%). The foregoing occurred despite that the income is still limited by a low interest margin sensitive to variations in the interest rate due to the segment it is intended to and to the recurring charges derived from the estimates and write-offs performed. The operational efficiency rate (non-financial expenses / gross income) obtained an outstanding 32.4%, which is favorable compared to the findings in other financial entities in general.

Historically, the capitalization levels of Navistar Financial have been maintained at good and reasonable levels. The equity-to-asset ratio is maintained at a favorable 21.7% as of the closing of 2Q18 (average 2014 - 2017: 18.7%) and Verum considers that, in the future, the total withholding of the company's profits will prevail as the main source of asset strength. The equity-total portfolio ratio was a high 27.7% in the same period and, during the last years, it has consistently been higher than 24%, which we consider is one of its major strengths. Additionally, the proportion of low-productivity assets (net non-performing portfolio + awarded assets + deferred taxes and other assets) on the equity registered a low 2.1% as of 2Q18, which does not significantly limit the entity's financial flexibility.

NF funds its operation through short-term and long-term loans hired to development and commercial bank, representing 77% of its liabilities with cost; as well as through issues of structured debts and unsecured short-term debt (23%). Furthermore, it is important to note that NFC provides NF with a committed credit line fully available in the amount of US$80 million, representing a significant strength to comply with the company's financial commitments; until now, there has been no need to use such line of credit.

The long-term rating perspective is "Stable". The rating might have a positive or negative variation depending on the financial situation of the parent company since it might have a direct effect on the operations of the Mexican subsidiary. Verum considers that the local operation has a high strategical importance. An increase in the ratings awarded to NF might occur if there is a significant improvement in the financial situation of NIC and in the case of maintaining or improving its good asset position and asset quality. On the other hand, the rating might be negatively pressured in case of impairment in the non-performing portfolio and in the allowance hedge affecting the income and/or due to a significant weakening of the entity's asset strength.

Navistar Financial was incorporated in 1997 as a SOFOL (regulated); it changed its business name to SOFOM in 2007. NF is subordinated to Navistar International Corporation (NIC), which helps NF to maintain a sound participation in the funding of the sales of the brand International in Mexico. The company's main activity is to grant funding to both distributors (wholesale loans) and individuals or entities (retail loans and financial lease, mainly) for the acquisition of trucks, tractor-trucks, buses and spare parts of the brand "International" through its distributors and sale points located in all the states of the Mexican Republic (2Q18: 79).

The following methodology has been employed to determine the ratings:

- Methodology for rating Banks and Other Financial Institutions (February 2018).

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