Verum ratifies the ratings awarded to Navistar Financial as 'BBB+/M' and '2/M'; Stable Perspective

Monterrey, Nuevo Leon (September 30, 2019): Verum ratified the long-term and short-term, counterparty risk rating of Navistar Financial, S.A. de C.V., SOFOM, E.R. (NF) as 'BBB+/M' and '2/M', respectively. Simultaneously, it ratified the '2/M' rating awarded to the Short-Term Bond Program in the amount up to MX$3 billion with maturity date in February 2022. The long-term rating perspective remains "Stable".

The ratification of NF's rating is backed up by a favorable and sound development in the financial performance, with an orderly growth, reflecting appropriate asset quality metrics for the sector it serves; as well as good asset levels, and a funding basis enough for future operations, as well as diversified by type of financial institution. As for the concentrations in the wholesale trade portfolio, they continue to be significant, but, historically, there has not been cases of non-performing portfolio in this product; additionally, changes might occur in the macroeconomic context which, ultimately, might reduce the rhythm of the loan placement of the SOFOM and put pressure, as applicable, on the payment capacity of some of its clients.

The ratings also take into account the strong existing synergies respect of operational and commercial aspects, as well as of the use of the brand, with Navistar International Corp. ("NIC"), its ultimately 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.

The sustained loan recovery, the continuity of a light, non-financial expenditure burden (1S19: 1.6% of its average assets), and the moderate reduction in the provision expenditures and write-offs (1S19: 21.4% of the pre-provisions operating profit; 2018: 21.8%) explain this financial institution's stable and recurring operating profit. The net profit during the first quarter in 2019 was MX$236 million (1S18: MX$194 million), showing asset profitability indicators and average equity of 2.8% and 12.6%, respectively, which are appropriate levels in the opinion of Verum, and they are in line with the company's historical average (2014 - 2018: 2.9% and 14.7%). The net financial margin (considering the net lease income) respect of its average asset was, as of the closing of 1S19, a moderate 5.1% (2018: 5.6%).

Additionally, it is worth to mention that, given the specialization level of NF in one single credit sector, which is the funding to purchase transport equipment (retail trade, wholesale trade, and lease), its performance has shown more sensitivity to the economic cycle, in comparison to other financial institutions with higher diversification and less vulnerability to the current economic environment.

The non-performing portfolio indicator has been maintained at reasonable levels considering the segment to which the SOFOM provides services, being 3.1% in June 2019; furthermore, in the last five years, this indicator has been maintained at appropriate levels, ranging from 2.4% 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. It is important to explain that the wholesale loan operation (floor plan) has not presented a non-performing portfolio. As for the allowance hedge of non-performing portfolio, it continues at good levels and with a tendency to grow, representing 1.1x respect of them. 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.

The accumulation of non-productive assets has been increasing in recent dates and it has taken a relatively important role within the administration of the SOFOM, since it amounts to MX$155 million at the same date; however, at Verum's judgment, the management has a demonstrated capacity for the conveyance of the awarded assets, by means of agreements entered into with the dealers.

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 2Q19, the main 10 borrowers represent 29.8% of the total portfolio and 1.1 times (x) the assets (including a related loan, which is its second main debtor: 5.6% and 0.2x, respectively).

The use of bank and stock funding has been moderate, in comparison with its asset quality, reflecting a reasonable leverage ratio (total liability/shareholder's equity), which, in 2T19, was 3.5x (average 2015 – 2018: 4.0x). Similarly, the shareholder's equity has been strengthened thanks to the sustained generation of profit during the last years, showing an equity/total assets ratio of 22.3%, which, in Verum's point of view, is deemed good; however, in the future, we expect the company to moderately increase its level of debt with cost, as long as the (transport) market conditions allow it.

NF funds its operation through short-term and long-term loans hired to development and commercial bank, representing 63% of its total liabilities with cost; as well as through issues of structured debts and unsecured short-term debt (12%). However, recently, the financial institution performed a significant substitution of liability, with parties now related (25%), which would allow to improve its financial margin during the last semester of 2019. 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 strategic relevance. 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 (2Q19: 90).

The following methodology has been employed to determine the ratings:

- Methodology for rating Banks and Other Financial Institutions (February 2019).

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Regulatory Information:

The last revision of Navistar Financial was carried out on September 24, 2018. The financial information used to analyze and determine such ratings comprises a 5-year term, beginning on January 1, 2014 to June 30, 2019.

The meaning of the ratings, an the explanation about the manner in which such ratings are determined and the regularity of the follow-up thereof, their particulars, attributes and limitations, as well as the rating methodologies, structure and the committee's voting process to determine the rating and criteria for the removal or suspension thereof can be reviewed on our web site http://www.verum.mx.

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The ratings indicated above are based on the information provided by the issuing company and/or obtained from sources taken as accurate and reliable, including audited financial statements, operational information, corporate presentations, sector analyses and regulatory analyses, among others, which information was reviewed by Verum, Calificadora de Valores, S.A.P.I. de C.V. exclusively, in the extent necessary and in relation to the awarding of the corresponding ratings, according to the methodology previously mentioned. In no case, it will be understood that Verum, Calificadora de Valores, S.A.P.I. de C.V. has validated, guaranteed or certified the accuracy, correctness or completeness of such information, Verum, Calificadora de Valores, S.A.P.I. de C.V. is not liable for any error or omission or for the results obtained from the analysis of such information.

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The ratings aforementioned were requested by the issuing institution (or on its behalf), so Verum, Calificadora de Valores, S.A.P.I. de C.V. has received the corresponding fees for the provision with its rating services. However, it is worth to mention that Verum, Calificadora de Valores, S.A.P.I. de C.V has not received any income from the issuing company for concepts other than those related to the study, analysis, opinion, assessment and judgment about the financial solvency and the rating awarding.