

2017

SECOND QUARTER



VARIATION ANALYSIS

REMARKS ON RESULTS
ABOUT THE FINANCIAL SITUATION

NAVISTAR FINANCIAL MEXICO

Navistar Financial came to Mexico in 1997 and operated together with Servicios Financieros Navistar, with the main goal of funding the Floor Plan of the International Dealers Network—a group created in 1996.

Because of the increasing market demand to get retail funding, during 1998 Arrendadora Financiera Navistar and Navistar Comercial were incorporated in order to be able to offer a wider range of financial products.

On December 7, 2017, it was agreed to carry out a merger between Arrendadora Financiera Navistar and Navistar Financial, which came into effect on January 1, 2008.

The main goal of this financial company in our country is to help its clients to be successful by offering them financial solutions based on a consistent and reliable service, as well as on a deep knowledge of the transport sector.

With the Financial Reform, which came into effect on January 10, 2014, among other provisions, it was established that SOFOMES ENR issuing debt must be entities regulated by the National Banking and Securities Commission (CNBV); later, on January 12, 2015, the federal government published on the Official Gazette of the Federation, the secondary regulations which modified the general provisions applicable to SOFOMES ENR (CUIFE), by means of which Navistar Financial became an “E.R.” entity regulated by the CNBV since March 1, 2015.



BALANCE SHEET HEADINGS

The financial information of Navistar Financial, S.A. De C.V. SOFOM E.R. (interchangeably "Navistar Financial" or the "Company") presented for fiscal year 2016 includes changes in the presentation in order to make it comparable to fiscal year 2017 (current regulations).

The Company's **Assets** show a positive variation of \$1,682.0 million Mexican pesos (mmp) in comparison to the 2Q16; such variation is mainly explained by an increase in the portfolio and equipment subject to operating leases.

The **Availabilities and Repurchases** have a negative variation of \$509.4 mmp, with a total balance of \$259.5 mmp, comprised by (i) \$133.9 mmp in cash restricted by the issuance of Senior Trust Bonds (CBF), which may be used to pay the liabilities of this same issue and (ii) \$125.6 for availabilities.

On October 7, 2016, resulting from a new issue of CBF NAVISCB 16, an Interest Rate Option was hired in compliance with the Trust Agreement entered into.

Consequently, the **Derivative** heading shows an increment of \$10.8 mmp compared to June 2016; the balance comprises a CCSwap, two Interest Rate Options acquired in compliance with the Trust Agreement entered into as a result of the issue of CBF, with a notional value of \$1.8 bmp, an Interest Rate Option of notional value of \$616.5 mmp, and a new Interest Rate Option with a notional value of \$536.3 mmp; such instruments show a mark-to-market ("MTM") of \$17.5 mmp.

The **Net Loan Portfolio** reflects an increment of \$1,065.9 mmp, equivalent to a positive variation of 10.8%, compared to 2Q16, which is explained mainly through:

- (i) Increase in the loan portfolio of \$1,016.5 mmp comprised by: a) Increase in the retail trade portfolio of \$692.9 mmp resulting from the commercial strategies implemented by Navistar Financial in 2017 and b) Increase of \$323.6 mmp in the short-term commercial loan portfolio for the financing of production orders for the United States of America and the national market.
- (ii) The **Non-Performing Loan Portfolio**, as of the closing of 2Q17, shows a balance of \$366.5 mmp, representing 3.4% of the total portfolio, according to the Exhibit 34 of the Single Circular of the Bank (2Q16 2.7%). This increment results mainly from the implementation of criteria to classify the non-performing portfolio of the Single Circular of the Bank. Despite this criteria implementation and factors such as cutback of the public expenditure, longer terms of credits granted by carriers to their clients, reduction of liquidity in the market and slowdown in the commercial sector related to the transport industry owing to the peso depreciation against dollar have impacted the liquidity of our clients, we have

managed to keep our indicator of non-performing loan healthy thanks to the strengthening of the collection strategies applied since the last months of 2016.

The **Preventive Credit Risk Estimate** shows an increment of \$50.6 mmp, maintaining a hedge of 1 time ("x") the expected loss and of 1.12 x the non-performing portfolio (2Q2016 1.35x). The appraisal of the preventive credit risk estimate is calculated according to the methodology of expected loss.

It is worth to mention that the company, as of June 30, 2017, has executed 6 Trusts, which are described below:

- A. On September 5, 2016, an Irrevocable Management Trust Agreement was entered into by Navistar Financial as Settlor and Trustee in Second Place, and Banco Invex, S.A., Institución de Banca Múltiple, Invex Grupo Financiero ("Invex"), as Fiduciary, and Monex Casa de Bolsa, S.A. de C.V., Monex Grupo Financiero, as Common Representative, with regard to the public offer of 5,363,830 CBF with a par value of MX\$100.00. (one hundred 00/100, Mexican pesos). The trust assets of this trust are comprised by a portfolio of \$470 mmp as of June 30, 2017.
- B. On September 5, 2015, an Irrevocable Management Trust Agreement was entered into by Navistar Financial as Settlor and Trustee in Second Place, and Banco Invex, S.A., Institución de Banca Múltiple, Invex Grupo Financiero ("Invex"), as Fiduciary, and Monex Casa de Bolsa, S.A. de C.V., Monex Grupo Financiero, as Common Representative, with regard to the public offer of 6,165,500 CBF with a par value of MX\$100.00. (one hundred 00/100, Mexican pesos). The trust assets of this trust are comprised by a portfolio of \$392 mmp as of June 30, 2017.
- C. On January 30, 2015, an Irrevocable Guarantee Trust Agreement was entered into by Navistar Financial as Settlor and Trustee in second place, Banco Invex, S.A., Institución de Banca Múltiple, Invex Grupo Financiero ("Invex"), as Fiduciary and CITIBANK, N.A. as Trustee in first place. Such agreement backs a line of credit hired with Banco Nacional de México S.A., member of Grupo Financiero BANAMEX "BANAMEX", which holds a 100% guarantee with the Export- Bank of the United States ("Exim"). As of the closing of June 2017, the balance of the contributed portfolio is \$399 mmp.
- D. In October, 2014, Navistar Financial ("Settlor", "Trustee in Second Place") entered into an Irrevocable Guarantee Trust Agreement with (i) Export Development Bank of Canada (EDC) "Trustee in First Place" and (ii) Invex as Fiduciary. The purpose of this guarantee is to back the line of the credit granted by EDC. The trust assets of this Trust, as of June 30, 2017, amount to \$1,192 mmp.
- E. In November, 2013, Navistar Financial ("Settlor", "Trustee in Second Place" and "Commission Agent") entered into an Irrevocable Guarantee Trust Agreement with (i) Nacional Financiera, Sociedad Nacional de Crédito, Institución de Banca de Desarrollo, Dirección ("Fiduciary") and (ii) Nacional Financiera, Sociedad Nacional de Crédito, Institución de Banca de Desarrollo ("NAFIN" and "Trustee" in First Place"). The purpose of

this guarantee is to back the line of credit in current account in favor of the Company. The trust assets of this Trust, as of June 30, 2017, amount to \$3,368 mmp.

- F. In May, 2013, an Irrevocable Management Trust Agreement was entered into by Navistar Financial as Settlor and Administrator, and Banco Invex, S.A., Institución de Banca Múltiple, Invex Grupo Financiero ("Invex"), as Fiduciary, and Monex Casa de Bolsa, S.A. de C.V., Monex Grupo Financiero, as Common Representative (The "Stock Trust"), with regard to the public offer of 18,000,000 CBF with a par value of MX\$100.00. (One hundred 00/100, Mexican pesos), both executed by Invex. As of the end of June 2017, the Trust has been fully paid therefore the remaining assets in this Trust were reverted in property to Navistar Financial as Second Fiduciary.

These amounts are presented under the heading "loan portfolio", "other accounts receivable" and "property in operating lease" in the balance sheets.

The net of other **Accounts Receivable and Accounts Payable** shows a negative variation of \$59.4mmp, because of the increment in the security deposit, consequence of the increment of retail funding in 2Q2017.

The heading **Awarded Assets**, as of the closing of June, 2017, shows a negative variation in the award indicator on the 34pbs portfolio as consequence of a less the stock rotation of these assets: 0.84% in 2Q17 against 0.50% in 2Q16.

In relation to **Equipment Intended to Operating Lease**, as of 2Q17 there are an increment of \$444.7 mmp compared to 2Q16, representing a growth of 28.2%. This resulted from the Operating Lease program, permanently focused on big fleets targeted funding.

The headings **Other Assets** shows a reduction of \$25.6 mmp, caused mainly by the increment in expenses for credit instrument issue.

As of the closing of 2Q17, the Company's **Net liabilities of liquid assets** reflect an increase of \$1,077 mmp, equivalent to an increase of 12.5% in comparison to the same period of the previous year, derived mainly from the increase of credit portfolio and the program of equipment subject to operating leases.

The heading **Stock Liability** shows a balance of \$2,467.4 mmp, comprised by the equity and interest of a, (i) CBF in the amount of \$312.8 mmp for the issue NAVISCB 15 (first issue under the \$5.000 bmp, 5 year revolving program authorized on November 5, 2015), (ii) CBF in the amount of \$375.2 mmp corresponding to the issue NAVISCB 16 (second issue under the \$5.000 bmp program), and (iii) [SIC] Short-Term Bonds ("CB") in the amount of \$1,779.4 mmp from a \$1.8-bmp program.

In **Bank Loans**, there is an increase of \$1,381.3 mmp against 2Q16, a consequence of the hiring and availability of funding sources with the commercial bank during the year. As of June 30, 2017 and 2016, the 41% and 39%, respectively, of the bank loan balance described

before are guaranteed by Navistar International Corporation "NIC" or by Navistar Financial Corporation ("NFC").

In 2Q17 and 2Q16, the bank liabilities are guaranteed by the loan portfolio and transport equipment intended to operating lease in the amount of \$8,446.1 and \$7,153.5 mmp, respectively. In addition, as of the closing of June, 2017, the company has a free current portfolio of \$3,829.6 mmp, getting a 2.16 times benchmark of free current portfolio, compared to the outstanding balance of the issue of the current commercial paper.

Moreover, the **Deferred Loans and Advanced Collections** show a positive variation of \$16.7 mmp, representing a variation of 17.4% compared to 2Q2016. This is mainly because an increment in the financial accrual income and commissions collected in advance because of loan granting.

The Company shows financial soundness, which is reflected on a capitalization level (equity/total portfolio) equivalent to 25.8% (2Q16 25.2%) and a net leverage level of the liquid assets of 3.9x (2Q16 3.7x), based on the bank covenants.

HEADINGS IN THE INCOME STATEMENT

The financial information corresponding to the fiscal year 2016 includes changes in its presentation in order to make it comparable to the same period in 2017 (current regulations). Additionally, the percentages related to portfolio are organized in an annual basis.

As of the closing of 2Q17, the **Financial Margin**, not affected by the exchange rate fluctuations, reaches \$262.4 mmp, which means a positive variation of \$5.9 mmp compared to the same period the previous year, which is explained mainly by the raise occurred in the funding rates of one year in comparison to the other. The interest coverage ratio for 2Q17, not affected by the exchange rate fluctuation, is 1.6x (1.8x 2Q16), so the Company is in compliance with the required bank obligations.

Regarding the **Preventive Credit Risk Estimates**, it shows a significant variation in relation to the previous year of \$52.8 mmp, representing an increment of 85%; this mainly because the implementation of criteria to classify the non-performing portfolio of the single circular of bank previously mentioned.

Consequently, the **Financial Margin adjusted by the credit risks**, not affected by the exchange rate fluctuation, shows a negative variation of \$46.9 mmp.

As part of the Operating Income, the following items are included.

- (i) The net of commissions and tariffs collected and paid shows a positive variation reflected in the income of \$30.4 mmp, because of the increment in the commissions collected for commercial loans derived from the increment in the retail loan portfolio.
- (ii) Intermediation income shows a positive impact of \$46.6 mmp, resulting from:
 - a) A positive variation of \$10.0 mmp, explained by the rate exchange fluctuation and derivative instruments; for analysis issues, the net impact of the currency position (excluded in the Financial Margin) must be taken, in 2Q2017 it reaches a loss of \$51.5 mmp against a loss of \$3.9 mmp in this same period the previous year.
 - b) Negative variation because of the Interest Rate transactions, this instrument shows a decrease in its 2017 value derived from the volatility of the Interbank Balance Interest Rate ("TIIE") and the long-term curve. Aggregate to 2Q16, there were negative effects of \$3.0 mmp on this instrument but during 2017 there has been negative effects of \$59.6 mmp.

Such instrument is monthly appraised to Fair Value, based on models commonly used in the financial markets for this kind of operations, and the variations in the instrument appraisal are recorded in the intermediation income, because, once the TIIE reference rate exceeds the interest rate agreed (6%) for IRCAP hired in 2013 and (5%) for IRCAP hired in 2015, the difference in the interest amount connected to this rate will be reimbursed by the financial intermediary in exchange of the premium paid at the beginning of the operation.

- (i) **Management Expenses**; the expenses indicator of the total managed portfolio is 2.16%, a number 35 pbs greater than the 1.81% of 2Q16. An increment of \$37.6 mmp is shown in comparison to the 2Q16, derived mainly from an increment in promotion expenses, expenses related to technological systems and other administration expenses.

Within the heading **Caused and Deferred Income Taxes**, a positive variation of \$31.1 mmp is shown; this effect is consequence of the income tax provision which reduction is directly related to the decrease in provisions for expenses and prepayments as well as an increase in deferred income.

FUNDING SOURCES

As of June 30, 2017, the Company had \$12,929.3 mmp in approved funding sources, which were distributed the following way: (i) 32.4% in domestic and foreign commercial bank, (ii) 48.6% in domestic and foreign development bank, (iii) 5.3% in CBF, and (iv) 13.7% in CB.

The Company maintains \$2,982.2 mmp in available lines with funding banks.

The available lines with NIC and NFC are still being operated as guarantee of some bank lines and/or as work capital through intercompany loans intended to the acquisition of new units or spare parts of the Floor Plan; in this latter case, as of the end of June, 2017, the line was not available as work capital.

Since November 2016, the company settles the loan with DCI (a Navistar Financial affiliate company); therefore, as of the closing of June, 2017, there is no balance with such affiliate.

In November, 2015, the first CBF issuance was performed under the Senior Bond Certificate program authorized on November 5, 2015 for up to \$5 bmp. This first issue, NAVISCB 15 in the amount of 616.5 mmp, was executed through the Trust 2537, opened with Invex, with a 1893-day term and with monthly amortizations. As of the closing of June 2017, the balance of the issue is \$312.8 mmp. The Company holds 100% of the property rights certificates of the aforementioned trust.

In September, 2016, the second CBF issuance was performed under the Senior Bond Certificate program authorized on November 5, 2015 for up to \$5 bmp. This first issue, NAVISCB 16 in the amount of \$419.2 mmp, was executed through the Trust 2844, opened with Invex, with a 1985-day term and with monthly amortizations. As of the closing of June, 2017, the balance of the issue is \$375.2 mmp. The Company holds 100% of the property rights certificates of the aforementioned trust.

Additionally, the Company maintains a short-term CBs program of \$1.8 bmp; such program was renewed and extended on February 17, 2017, and its balance as of June 30, 2017 is \$1,779.3 mmp.

Below, there is a breakdown of the debt by currency and rate. The debt is expressed in thousands in the currency indicated.

	Jun-17	%	Jun -16	%
Debt in pesos fixed rate	3,434,438	42%	2,331,249	34%
Debt in pesos with CAP	685,374	8%	1,614,741	23%
Debt in pesos variable rate	4,133,912	50%	2,936,533	43%
TOTAL PESOS	8,253,724		6,882,523	
Debt in dollars fixed rate	0	0%	10,032	7%
Debt in dollars variable rate	99,066	100%	128,766	93%
TOTAL DOLLARS	99,066		138,798	

The Company, within its risk management activities, frequently requires hiring financial derivative instruments, such as Currency Swaps (CCSwap), which help Navistar Financial to keep optimal levels of safety, liquidity and costs without importing the currency in which the credit or loan operation may be performed.

As of June 30, 2017, the Company did not had hired a CCSwap.

According to the Trust Agreement entered into as a result of the issue of the CBF NAVISCB 13, two Interest Rate Options were hired under the following conditions:

- CAP on TIIE
- Notional: 1.0 bmp
- Start date: May 31, 2013
- Maturity date: May 15, 2018
- Counterparty: BANCO NACIONAL DE MÉXICO S. A. MEMBER OF GRUPO FINANCIERO BANAMEX
- Strike: 6%
- Premium: 13.5 mmp
- CAP on TIIE
- Notional: 800.0 mmp
- Start date: November 29, 2013
- Maturity date: May 15, 2018
- Counterparty: BBV A BANCOMER S. A.
- Strike: 6%
- Premium: 12.1 mmp

According to the Trust Agreement entered into as a result of the issue of the CBF NAVISCB 15, one Interest Rate Options were hired under the following conditions:

- CAP on TIIE
- Notional: 616.5 mmp
- Start date: December 3, 2015
- Maturity date: August 15, 2019
- Counterparty: BBV A BANCOMER S. A.
- Strike: 5%
- Premium: 3.6 mmp

Additionally, and according to the Trust Agreement entered into as a result of the issue of the CBF NAVISCB 16, one Interest Rate Options were hired under the following conditions:

- CAP on TIIE
- Notional: 536.3 mmp
- Start date: October 07, 2016
- Maturity date: September 15, 2020
- Counterparty: BBV A BANCOMER S. A.
- Strike: 6%
- Premium: 4.6 mmp

Consistently, the Company carries out these transactions in the OTC market and, as part of its guidelines, the institutions with which it operates or executes the derivatives must be institutions with which it has entered into an ISDA (International Swap Dealers Association) Agreement. The counterparties must be financial institutions approved by Navistar Financial, in which case, each assignment is the result of a global relationship with the respective entity, besides considering risk factors, economic soundness and commitment of each selected institution.



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