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Nacional Financiera S.N.C. (NAFIN)

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Nacional Financiera S.N.C. (NAFIN)

SACP	bb+

Anchor	bbb-	
Business Position	Adequate	0
Capital and Earnings	Moderate	-1
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Adequate	

\+

Support	+2
ALAC Support	0
GRE Support	+2
Group Support	0
Sovereign Support	0

\+

Additional Factors	0

Issuer Credit Rating

BBB/Negative/A-2

Major Rating Factors

Strengths:	Weaknesses:
• Solid market position in the Mexican banking system as the second largest development bank and the sixth largest bank in the country; • Manageable asset quality indicators despite the ongoing pandemic, oil price shock, and Mexico's economic downturn; and • Explicit guarantee from the federal government to support all of its financial obligations.	• Limited business diversification, reflecting its main role of developing the small to mid-size enterprise (SME) sector in Mexico; and • Lower capitalization levels compared with other development banks in Mexico.

Outlook : Negative

The negative outlook on Nacional Financiera S.N.C. (NAFIN) reflects our status as a government-related entity (GRE)--given our view of its critical role and integral link to the Mexican government, therefore, if we downgrade the sovereign in the coming 12-24 months due to uneven or ineffective policy execution, potentially weakening public finances, or higher off-budget contingent liabilities, we could take the same action on the bank.

Upside scenario

Conversely, we could revise the bank's outlook to stable in the next 12-24 months following a similar action on the sovereign, which could result from effective economic management that raises investor confidence, encourages private investment, and maintains moderate fiscal deficits that could reverse the structural weakness in GDP growth prospects.

Rationale

The ratings on NAFIN reflect our expectations that despite its limited business diversification, the bank will maintain resilient to the ongoing pandemic, supported by its solid market share in the financial system and its higher financial flexibility compared with the average of the Mexican banks (which stems from its position as a government-related entity [GRE]). Our ratings also incorporate a projected risk-adjusted capital (RAC) ratio of about 5.6% for the next two years. Although we expect pressures on its asset quality metrics due to turmoil caused by the pandemic, we expect them to remain manageable and healthier than the Mexican banking system's average. Finally, we consider that NAFIN's GRE status provides it with greater financial flexibility compared with other Mexican banks, allowing it to effectively manage its liquidity profile.

Anchor: 'bbb-' for banks operating only in Mexico

Mexican banks now face higher economic risks due to the continued weakening economy, which has led to lower economic resilience. This is illustrated by the economic slump of 2019, which eroded the private sector's business and investment confidence, and by the continued worsening of the energy sector. Lower economic resilience is also demonstrated by the even weaker economic prospects for 2020, exacerbated by the global turbulence resulting from COVID-19 and plummeting oil prices. In this context, we expect the Mexican economy will contract, for a second consecutive year, and then will slightly recover in the next three years (growth of slightly over 2.0% in 2021 and 1.8% in 2022-2023). In this sense, we expect credit expansion to remain modest in 2020-2021, in real terms, due to low credit demand from the corporate and commercial sector and from households. Despite the weak economic outlook for 2020-2021 and the forecast of modest credit growth and lower interest rates, we expect Mexican banks to maintain adequate asset quality and profitability metrics, based on their continued conservative growth strategies and lending practices. In our opinion, Mexico's current economic risk level already captures a potential deterioration in these metrics.

Our economic risk trend on Mexico's Banking Industry Country Risk Assessment (BICRA) is stable. This is because although we expect weak economic conditions to persist in 2020, we don't expect asset quality metrics to significantly worsen (including nonperforming assets [NPAs] and credit losses) and anticipate profitability to remain adequate (despite lower interest rates and potentially higher reserve requirements), based on banks' conservative growth strategies and lending practices. In our opinion, the current economic risk level already captures a potential deterioration in these metrics. However, we'll remain alert to a potential worsening in the trajectory of Mexican banks' asset quality metrics and profitability, which if significantly above our expectations in the next 12-18 months, could lead us to revise Mexico's BICRA economic risk trend to negative from stable.

The Mexican banking system benefits from its institutional framework that's in line with international standards. This allows the industry's capitalization, funding, and liquidity levels to remain sound. Nonetheless, we still see room for improvements. For instance, we believe the banking regulator would benefit from more extensive coverage of the financial system and from tougher oversight of non-bank financial institutions (NBFIs), including those that don't only issue debt in the domestic market, along with a focus on fraud prevention. The Mexican banking system remains highly concentrated, and barriers to entry are high. We expect healthy competitive dynamics to remain as a key characteristic of Mexico's banking industry. While competition from fintech start-ups could pressure the profitability of existing financial institutions, we expect to see a collaborative relationship between commercial banks and fintech companies rather than a rivalry. Mexican banks are mainly funded through "sticky" (i.e. high customer retention) and fragmented deposit bases. This has allowed banks to deliver sound profitability, despite still high interest rates. The domestic debt capital market also will continue to enhance the banking system's financial flexibility.

The trend in Mexico's industry risk remains stable. We believe the Mexican banking industry benefits from its long track record of implementing international regulatory standards and cautious oversight, and from healthy competitive dynamics. However, if the departure of experienced staff from the banking regulator--due to the new government's austerity law--weakens the quality of supervision, or results in significant delays in adopting additional international practices--such as the International Financial Reporting Standards (IFRS)-9--signaling potential governance and transparency issues, it could affect our institutional framework assessment. Moreover, if competitive dynamics shift--in the form of directed lending, or greater use of government-owned banks with relaxed lending practices--or if the banking regulatory framework relaxes, it would result in higher industry risk. If the administration decides to adopt such practices or if the central bank's independence diminishes, we could revise the BICRA's industry risk score to a weaker category, potentially weakening domestic financial entities' creditworthiness. An additional challenge for Mexican banks in the next two years will be increasing their deposit base, because we expect lower interest rates and challenging economic conditions that could limit growth of households' savings.

Table 1

Nacional Financiera S.N.C. (NAFIN) Key Figures

		--Year-ended Dec. 31--			
(Mil. MXN)	**2020***	**2019**	**2018**	**2017**	**2016**
Adjusted assets	605,367.0	550,930.0	582,917.0	516,230.0	503,541.0
Customer loans (gross)	246,485.0	225,950.0	259,632.0	228,459.0	214,313.0
Adjusted common equity	30,372.3	30,652.3	28,119.0	24,758.0	28,287.0
Operating revenues	2,398.0	1,731.0	9,475.0	7,750.0	6,608.0

Table 1

Nacional Financiera S.N.C. (NAFIN) Key Figures (cont.)

		--Year-ended Dec. 31--			
(Mil. MXN)	**2020***	**2019**	**2018**	**2017**	**2016**
Noninterest expenses	858.0	2,995.0	3,580.0	3,261.0	3,181.0
Core earnings	1,081.0	(2,276.0)	2,535.0	1,507.0	1,350.0

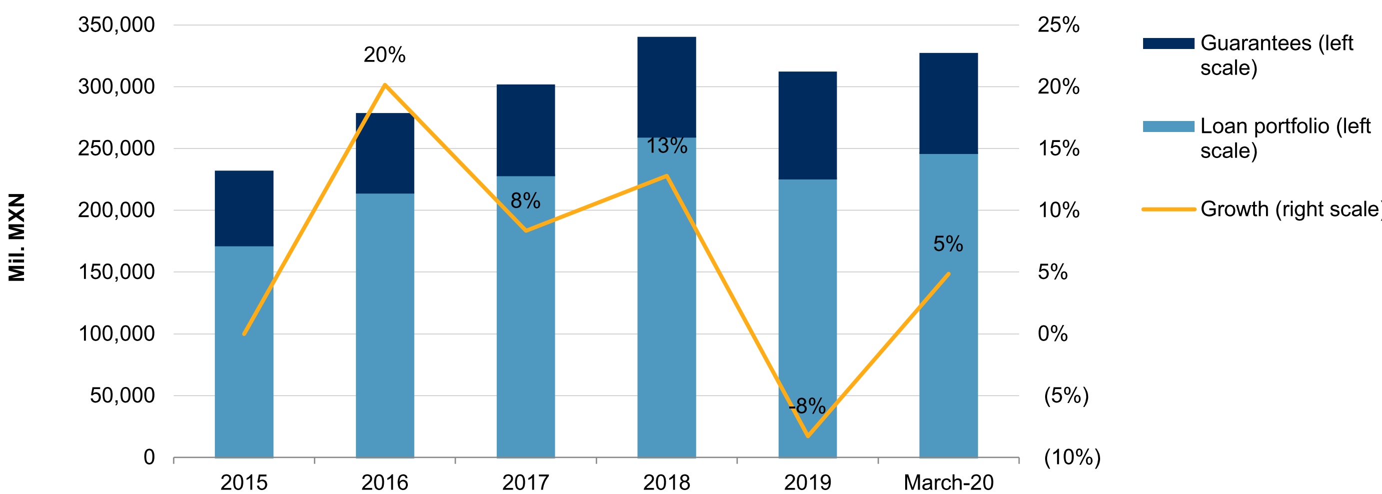
*Data as of March 31. MXN--MXN-Mexican peso.

Business position: Stable and supported by solid market share and more financial flexibility

Given the bank's purpose of helping develop the SME sector, we expect NAFIN to grow higher than the Mexican banking system, despite current adverse economic conditions. The bank's support measures will be focus on additional working capital lines and holiday periods for existing first-floor clients. Additionally, the guarantees program to the SMEs segment is still active through a second-floor scheme. Therefore, we expect the loan portfolio to grow about 6% this year compared with the 4% average for the Mexican banking system. Furthermore, despite limited business diversification, the bankś market positon as the second largest development bank in Mexico and its GRE status--that provides greater financial flexibility--will help NAFIN maintain relatively stable business operations.

Chart 1

Loan Portfolio And Off-Balance Guarantees



MXN--Mexican peso. Source: S&P Global Ratings.

Table 2

Nacional Financiera S.N.C. (NAFIN) Business Position

		--Year-ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Total revenues from business line (currency in millions)	2,398.0	1,731.0	9,475.0	7,750.0	6,608.0
Trading and sales income/total revenues from business line	(2.6)	2.4	13.9	(15.6)	(11.3)

Table 2

Nacional Financiera S.N.C. (NAFIN) Business Position (cont.)

		--Year-ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Other revenues/total revenues from business line	10.9	(414.8)	16.0	14.2	2.0
Investment banking/total revenues from business line	(2.6)	2.4	13.9	(15.6)	(11.3)
Return on average common equity	11.5	(6.2)	7.3	5.2	5.2

*Data as of March 31.

Capital and earnings: Projected RAC ratio of 5.6% for the next 12-24 months

Our capital and earnings assessments is supported by our forecast RAC ratio of 5.6% for the next two years. The ratio reflects our expectation of Mexico's higher economic risk and similar government fees ("aprovechamientos"), counterbalanced by government capital injections and lower but positive internal capital generation due to higher reserve coverage thanks to the ongoing pandemic. Our base-case scenario incorporate the following assumptions:

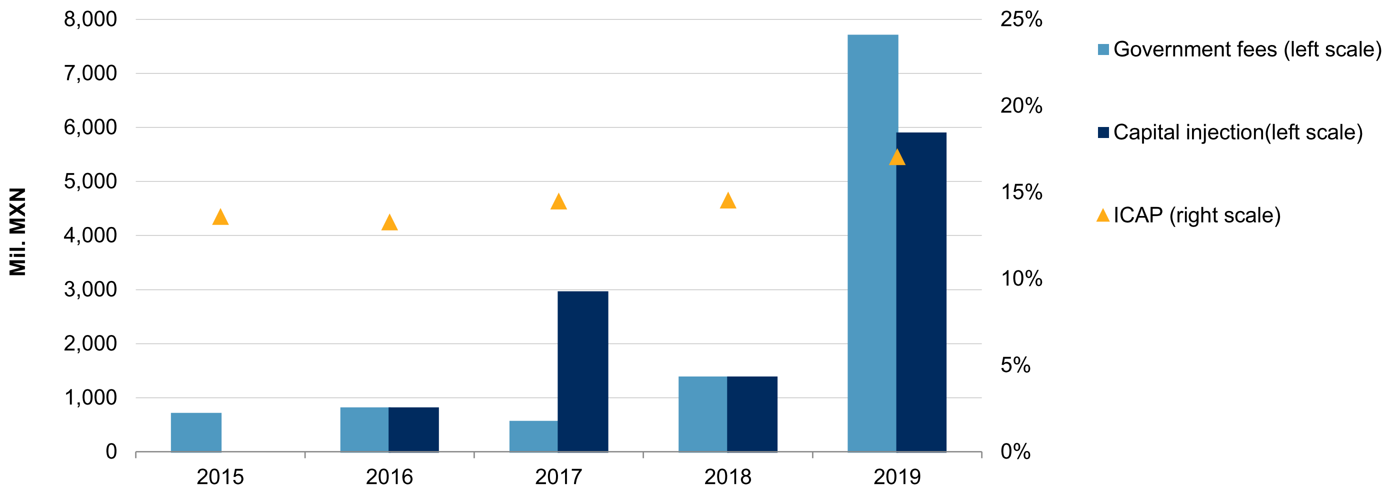
- Mexico's GDP to contract 6.7% in 2020 and to grow 2.9% in 2021.
- Loan portfolio growth of about 6%, on average, for 2020 and 2021, with a similar trend for off-balance sheet guarantees.
- A drop in net interest margins (NIMs) to around 85 basis points (bps) for the next two years;
- An increase in NPAs to about 2% during 2020, fully covered by reserves; and
- Similar amount of government fees payment compared to previous years.

The bank's capitalization levels were not affected at the end of 2019 by the negative bottom-line results. The bank received a capital injection of MXN5.9 billion coupled with accounting effect on taxes, which mitigated its losses. Therefore, our RAC ratio was 7.1% at year-end 2019. Additionally, as of March 2020, the bank's ICAP level was 15.5%, well above the regulatory minimum of 10.5%.

We consider that there will be a slight impact on the bank's profitability levels, reflecting higher loan loss reserves and lower operating revenues that are hampering bottom-line income. We expect core earnings to average adjusted assets to decrease 15 bps compared with its three-year average. We note that profitability levels are still lower than the average of the Mexican banking system, reflecting NAFIN's mandate to promote and support the SME segment in the country.

Chart 2

Government Fees Versus Capital Injections



Source: S&P Global Ratings.

Table 3

Nacional Financiera S.N.C. (NAFIN) Capital And Earnings					
		--Year-ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	15.5	17.0	14.5	14.5	13.3
Net interest income/operating revenues	53.6	333.4	40.1	67.9	71.7
Fee income/operating revenues	38.1	179.0	30.0	33.5	37.6
Market-sensitive income/operating revenues	(2.6)	2.4	13.9	(15.6)	(11.3)
Noninterest expenses/operating revenues	35.8	173.0	37.8	42.1	48.1
Preprovision operating income/average assets	1.1	(0.2)	1.1	0.9	0.8
Core earnings/average managed assets	0.7	(0.4)	0.5	0.3	0.3

*Data as of March 31.

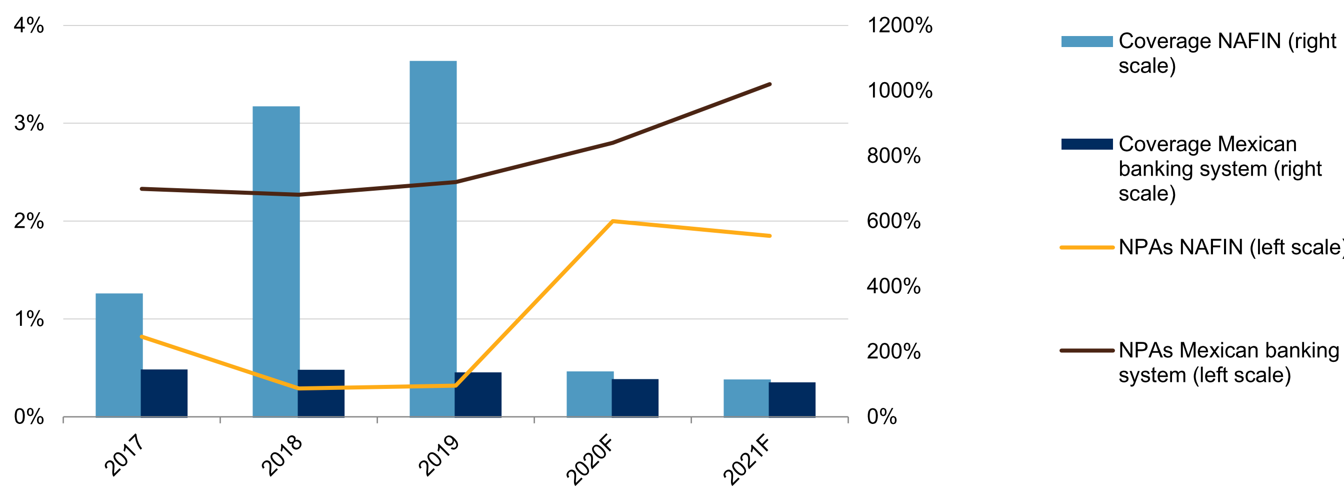
Risk position: Manageable asset quality metrics, despite adverse market conditions

Although we expect asset quality deterioration due to the economic slump this year, we anticipate manageable NPAs. The latter reflects NAFIN's prudent underwriting standards and a well-diversified loan portfolio by economic sector. For 2020-2021, we expect NPAs to increase to 1.9% compared with 0.3% during 2019, with credit losses below 2.0% from marginal losses--in both cases healthier than the average for the Mexican banking system. We expect loan loss reserves of at least 1.0x of the bank's total NPAs.

Furthermore, the bank will continue focusing on its core banking businesses and strategic sectors, such as the energy, agroindustry, auto, petro-chemistry, mining and telecommunications sectors, among others, as it continues to develop the SMEs sector though second floor lending activities and its guarantees program. As of March 2020, financial institution loans represented 73% of NAFIN's total loans. Commercial and corporate (24%) and others (3%) made up the remaining 27%.

Chart 3

Asset Quality
Nafin compared to Mexican banking system



F--Forecast. NPA--Non performing assets. Source: S&P Global Ratings.

Table 4

Nacional Financiera S.N.C. (NAFIN) Risk Position

		--Year-ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Growth in customer loans	(1.2)	(13.0)	13.6	6.6	24.8
Total managed assets/adjusted common equity (x)	19.9	18.0	20.7	20.9	17.8
New loan loss provisions/average customer loans	0.3	0.4	1.2	1.2	0.8
Net charge-offs/average customer loans	N.M.	0.0	0.5	0.1	0.3
Gross nonperforming assets/customer loans + other real estate owned	0.3	0.3	0.3	0.8	1.0
Loan loss reserves/gross nonperforming assets	882.2	1,088.0	948.9	375.0	257.8

*Data as of March 31. N.M.--Not meaningful.

Funding and liquidity: Higher financial flexibility reflected in their full guarantee from the Mexican federal government

NAFIN's diversified funding base and its strategy to extend its maturity profile will help the bank cope the economic conditions. Additionally, the explicit support that NAFIN receives from the Mexican government gives it greater financial flexibility compared with other banks in the country.

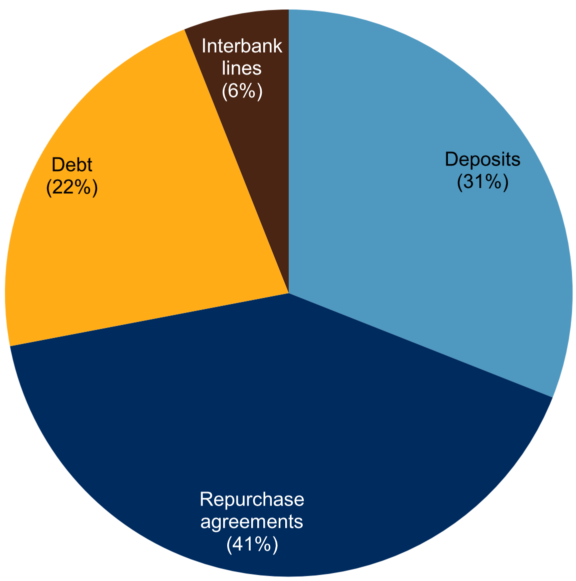
At the end of March 2020, the bank's funding structure consisted of repurchase agreements (41%), deposits (PRLVs and Cedes) (31%), market debt (22%), and interbank lines (6%). The bank's stable funding ratio (SFR) was 97.6% as of

March 2020 (87.6% on average in the past three years) reflecting NAFIN's stable funding base and the growing deposits base. We expect the SFR to remain above 90% in the next two years since we don't anticipate any changes in the bank's funding structure. The bank will finance its long-term funding needs with long-term liabilities to avoid significant mismatches in the balance sheet.

We expect liquidity levels to decrease this year, reflecting recent economic conditions; however, liquidity will remain sufficient to cover the bank's financial needs and business operations. The latter is also underpinned by the bank's low refinancing risk. As of March 2020, its broad liquid assets to short-term wholesale funding, was 1.10x with a three-year average of 0.98x. NAFIN's liquidity continues to reflect prudent management and a stable funding base. Like other banks in the system, NAFIN uses an investment portfolio mainly composed of federal government securities, which we consider to be highly liquid.

Chart 4

Funding Base
As of March 2020



Source: S&P Global Ratings.

Table 5

Nacional Financiera S.N.C. (NAFIN) Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Core deposits/funding base	30.5	29.6	28.0	29.1	30.7
Customer loans (net)/customer deposits	144.3	149.9	175.6	164.9	145.4

Table 5

Nacional Financiera S.N.C. (NAFIN) Funding And Liquidity (cont.)					
		--Year-ended Dec. 31--			
(%)	2020*	2019	2018	2017	2016
Long-term funding ratio	52.2	46.4	48.6	50.8	49.3
Stable funding ratio	97.6	90.6	88.1	84.2	86.5
Short-term wholesale funding/funding base	51.3	57.9	55.1	52.7	53.8
Broad liquid assets/short-term wholesale funding (x)	1.1	1.0	1.0	0.9	0.9
Short-term wholesale funding/total wholesale funding	73.8	82.3	76.5	74.3	77.6

*Data as of March 31.

Support: Almost certain likelihood of extraordinary government support

We base our assessment of the almost certain likelihood of extraordinary government support from Mexico in the event of financial distress on the following:

- NAFIN plays a critical role to the government given its ability to provide financing SMEs, thereby, promoting economic development in the country. NAFIN has a fundamental role as a public policy instrument, mitigating barriers to financing SMEs, providing more credit under better conditions, and implementing several programs that extend credit to SMEs.
- NAFIN has an integral link with the government, considering its explicit guarantee that it will cover the bank's financial obligations. Additionally, the government appoints the bank's board members and determines its general strategy according to economic policies and the federal budget. We expect these conditions to remain unchanged.

NAFIN's integral link to, and critical role for, the government leads to an almost certain likelihood of government support under our government-related entity (GRE) criteria. We don't expect our GRE assessment to change over the next two years.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And

Assumptions, Nov. 9, 2011

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	5	**6**	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	**bbb-**	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of June 18, 2020)*

Nacional Financiera S.N.C. (NAFIN)		
Issuer Credit Rating		
Foreign Currency		BBB/Negative/A-2
Local Currency		BBB+/Negative/A-2
CaVal (Mexico) National Scale		mxAAA/Stable/mxA-1+
Certificate Of Deposit		
Foreign Currency		BBB/A-2
Senior Secured		
CaVal (Mexico) National Scale		mxAAA
Issuer Credit Ratings History		
27-Mar-2020	*Foreign Currency*	BBB/Negative/A-2
04-Mar-2019		BBB+/Negative/A-2
19-Jul-2017		BBB+/Stable/A-2
23-Aug-2016		BBB+/Negative/A-2
27-Mar-2020	*Local Currency*	BBB+/Negative/A-2
04-Mar-2019		A-/Negative/A-2
19-Dec-2017		A-/Stable/A-2
19-Jul-2017		A/Stable/A-1
23-Aug-2016		A/Negative/A-1
27-Sep-2004	*CaVal (Mexico) National Scale*	mxAAA/Stable/mxA-1+
Sovereign Rating		
Mexico		
Foreign Currency		BBB/Negative/A-2
Local Currency		BBB+/Negative/A-2

Ratings Detail (As Of June 18, 2020)*(cont.)	
CaVal (Mexico) National Scale	mxAAA/Stable/--
Related Entities	
Banco del Bienestar, Sociedad Nacional de Credito, Institucion de Banca de Desarrollo	
Issuer Credit Rating	
CaVal (Mexico) National Scale	mxAAA/Stable/mxA-1+
Banco Nacional de Comercio Exterior S.N.C.	
Issuer Credit Rating	
Foreign Currency	BBB/Negative/A-2
Local Currency	BBB+/Negative/A-2
CaVal (Mexico) National Scale	mxAAA/Stable/mxA-1+
Senior Secured *CaVal (Mexico) National Scale*	mxAAA
Banco Nacional de Obras y Servicios Publicos S.N.C.	
Issuer Credit Rating	
Foreign Currency	BBB/Negative/A-2
CaVal (Mexico) National Scale	mxAAA/Stable/mxA-1+
CFE International, LLC	
Issuer Credit Rating	BBB/Negative/--
Comision Federal De Electricidad	
Issuer Credit Rating	
Foreign Currency	BBB/Negative/--
Local Currency	BBB+/Negative/--
CaVal (Mexico) National Scale	mxAAA/Stable/--
Senior Unsecured *CaVal (Mexico) National Scale*	mxAAA
Senior Unsecured	BBB
Senior Unsecured	BBB+
Fideicomiso Irrevocable de Administracion y Emision de Certificados Bursatiles Fiduciarios No. 2595	
Senior Unsecured *CaVal (Mexico) National Scale*	mxAAA
Instituto Para La Proteccion al Ahorro Bancario	
Issuer Credit Rating	
Foreign Currency	BBB/Negative/A-2
Local Currency	BBB+/Negative/A-2
CaVal (Mexico) National Scale	mxAAA/Stable/mxA-1+
Senior Unsecured *CaVal (Mexico) National Scale*	mxAAA
Senior Unsecured	BBB+
Kot Insurance Co. A.G.	
Financial Strength Rating	
Local Currency	BBB+/Negative/--
Issuer Credit Rating	
Local Currency	BBB+/Negative/--

Ratings Detail (As Of June 18, 2020)*(cont.)	
MEX GAS SUPPLY S.L.	
Issuer Credit Rating	
Foreign Currency	BBB/Negative/--
Local Currency	BBB+/Negative/--
Mexico	
Issuer Credit Rating	
Foreign Currency	BBB/Negative/A-2
Local Currency	BBB+/Negative/A-2
CaVal (Mexico) National Scale	mxAAA/Stable/--
Transfer & Convertibility Assessment	A
Senior Unsecured	BBB
Senior Unsecured	BBB+
Short-Term Debt	A-2
Petroleos Mexicanos	
Issuer Credit Rating	
Foreign Currency	BBB/Negative/--
Local Currency	BBB+/Negative/--
CaVal (Mexico) National Scale	mxAAA/Stable/mxA-1+
Senior Unsecured *CaVal (Mexico) National Scale*	mxAAA
Senior Unsecured	BBB
Senior Unsecured	BBB+
PMI Norteamerica S.A. de C.V.	
Issuer Credit Rating	
Foreign Currency	BBB/Negative/--
Local Currency	BBB+/Negative/--
P.M.I. Trading Ltd.	
Issuer Credit Rating	
Foreign Currency	BBB/Negative/--
Local Currency	BBB+/Negative/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.