

Bond Analysis: Inversiones Atlantida S.A. 7.500% 2026

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Bond Recommendation:

Appetite for Low Risk: UNDERWEIGHT

Appetite for Moderate Risk: MARKETWEIGHT

Appetite for High Risk: OVERWEIGHT

ABOUT THE COMPANY

Inversiones Atlantida S.A. (INVATLAN) is one of the largest financial services groups in Honduras and, through its subsidiaries, it offers a wide range of corporate and retail banking, insurance, pension fund management and other financial services to more than 3.9 million clients as of September 30, 2022.

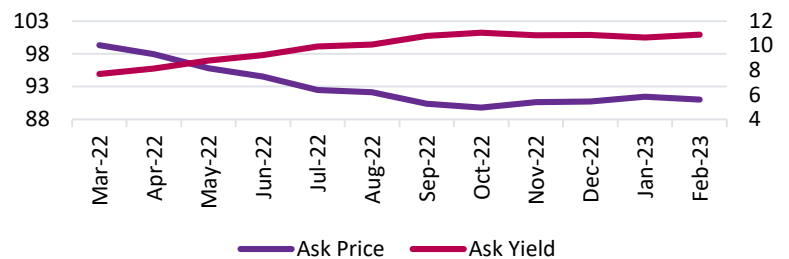
In terms of its banking distribution networks, as of September 30, 2022, INVATLAN had 3,984 service points in Honduras, which together with its insurance distribution network and other operations in Honduras, El Salvador and Nicaragua added 4,099 service points as follows:

- 262 branches (146 agencies, 61 teller windows embedded within corporate client offices, 23 drive thru and 32 branches related to the other business lines of the Group);
- 1,185 ATMs (423 proprietary ATMs and 762 third-party network ATMs); and
- 2,652 non-correspondent banking agents.

Inversiones Atlantida S.A.: Bond Term Summary

Issuer	Inversiones Atlantida S.A.
Currency	USD
Issued Amount	300,000 (M)
Issue Date	May 19, 2021
Tenor	5 Years
Ask Price¹	\$90.796
Ask Yield to Maturity¹	10.996%
Coupon	7.500%
Credit Rating (S&P)	B
Outlook (S&P)	Negative
Maturity	May 19, 2026
Maturity Type	Callable on: 05/19/2023 @ 103.00 05/19/2024 @ 101.50 05/19/2025 @ 100.00
Day Count Basis	30/360
Use of proceeds	General Corporate Purposes; Refinance

Historical Price and Yield



Recommendation: We believe INVATLAN's senior secured 7.5% '26 notes offer potential upside given the recent price decline and high yield. The price decline offers an entry opportunity for investors, especially as the Group continues to recover from the impact of the pandemic, supported by stable funding sources and adequate liquidity. Notwithstanding, based on credit rating agency views, INVATLAN may experience some headwinds in the near future as a result of higher economic risks at the level of the sovereign (Honduras). We therefore recommend that investors participate in these instruments based on their risk appetite.

¹ As at March 9, 2023

ECONOMIC OVERVIEW – HONDURAS (S&P RATING: BB-/Negative)

According to Standard & Poor's (S&P), Honduras is a relatively small, open economy with substantial informality, affecting an estimated 70% of the working population. The modest, albeit growing, physical infrastructure and Honduras' susceptibility to outside shocks is expected to continue to restrain the country's economic growth over the next three to five years. Due to years of low investment and low competitiveness, its per capita income growth has also suffered. On July 21, 2022, S&P affirmed the credit rating for Honduras at 'BB-' while revising the outlook to Negative from Stable on expected fiscal weakening based on its government's implementation of economic policies to address social priorities which might weigh on spending, amid economic slowdown, inflationary pressures and adverse and complex global conditions. The IMF estimated real GDP growth of 12.5% for 2021. Real GDP for 2022 and 2023 are forecasted to be 3.4% and 3.5% respectively.

COMPANY OUTLOOK

Strong brand name recognition, steady credit growth and low cost of funding to drive future performance

We view INVATLAN's business position as a reflection of the brand name popularity and stability of Banco Atlantida, INVATLAN's largest subsidiary, and the largest bank in Honduras in terms of deposits and loans. Banco Atlántida occupies a prominent position in the local market in terms of total assets, loans and interest receivable and deposits, with market shares of 17.4%, 20.4% and 20.8%, respectively, as of September 30, 2022, according to data from Comision Nacional de Bancos y Seguros² (CNBS). According to CNBS, Seguros Atlántida is also one of the largest insurers in terms of gross written premiums, with a market share of 14.8% and 15.4% as of September 30, 2022 and 2021, respectively. AFP Atlántida is the largest private pension fund manager in Honduras with a 58.4% market share in terms of assets under management as of September 30, 2022.

Similar to Banco Atlantida, S&P anticipates INVATLAN to continue to benefit from an expanding deposit base over the next 12 to 24 months, allowing it to keep its cost of capital low and increase its margins. S&P also expects that INVATLAN's loan portfolio should keep growing as a result of the commercial lending business likely recovering more quickly than the consumer loan segment. In addition, although the revenue generated by INVATLAN subsidiaries outside of Honduras is still a minor portion of the group's overall revenue, S&P expects it to steadily increase. Similarly, it is anticipated that better results from INVATLAN's insurance businesses should accrue in the coming years, following the disappointing 2021 results brought on by the pandemic. It is expected that these elements, along with INVATLAN's operational effectiveness and cost management, should raise operating revenue for the group by roughly 10% over the next two years.

Negative outlook for Honduras may weight on INVATLAN's credit rating

S&P has stated that it may adjust INVATLAN's credit rating and outlook in tandem with any changes it makes to the sovereign's rating and outlook. S&P expects a one-in-three (33.33%) likelihood that it could lower its rating on Honduras (BB-/Negative) in the next 18 months.

² Comision Nacional de Bancos y Seguros (CNBS) is a Finance Industry regulator in Honduras.

FINANCIAL ANALYSIS

(In thousands of Lempiras ³)	FY 2019	FY 2020	FY 2021	9M 2021	9M 2022
	31-Dec-19	31-Dec-20	31-Dec-21	30-Sep-21	30-Sep-22
Revenue					
Net Interest Income	3,967,585	3,887,808	4,486,623	3,078,438	4,495,138
Net Income from Insurance Activities	483,838	525,265	510,005	371,112	358,548
Net Commissions and fees (services)	3,593,746	3,760,742	4,731,493	3,417,404	3,976,008
Total Net Revenue	8,045,169	8,173,815	9,728,121	6,866,954	8,829,694
Total Other Expenses	6,316,418	6,740,065	8,266,809	5,879,192	6,905,131
Net Profit	1,286,649	790,580	1,127,754	692,845	1,194,132
Total Assets	119,393,767	141,389,735	165,632,895	155,703,402	174,134,507
Total Liabilities	105,304,830	126,370,302	149,545,108	140,114,666	156,751,312
Total Shareholders' Equity	12,464,399	13,168,609	14,090,305	13,664,996	15,285,856
Total Long-term Debt	6,778,077	7,329,106	11,396,531	10,231,262	12,439,926
Total Equity-to-Total Assets (%)	10.4%	9.3%	8.5%	8.8%	8.8%
Return on Equity (%)	10.3%	6.2%	8.3%	6.8%	11.0%
Long term Debt-to-Equity (Leverage) (x)	0.54x	0.56x	0.81x	0.75x	0.81x
Net interest Margin (%)	4.2%	4.2%	3.8%	3.4%	4.0%
Non-performing loans of % of Gross Loans	1.9%	2.4%	2.3%	2.3%	2.5%
Net cash flow from operating activities	5,143,885	16,116,149	(2,056,567)	3,847,104	(3,326,139)

Source: INVATLAN's Financial Statements

Earnings revert to pre-pandemic levels.

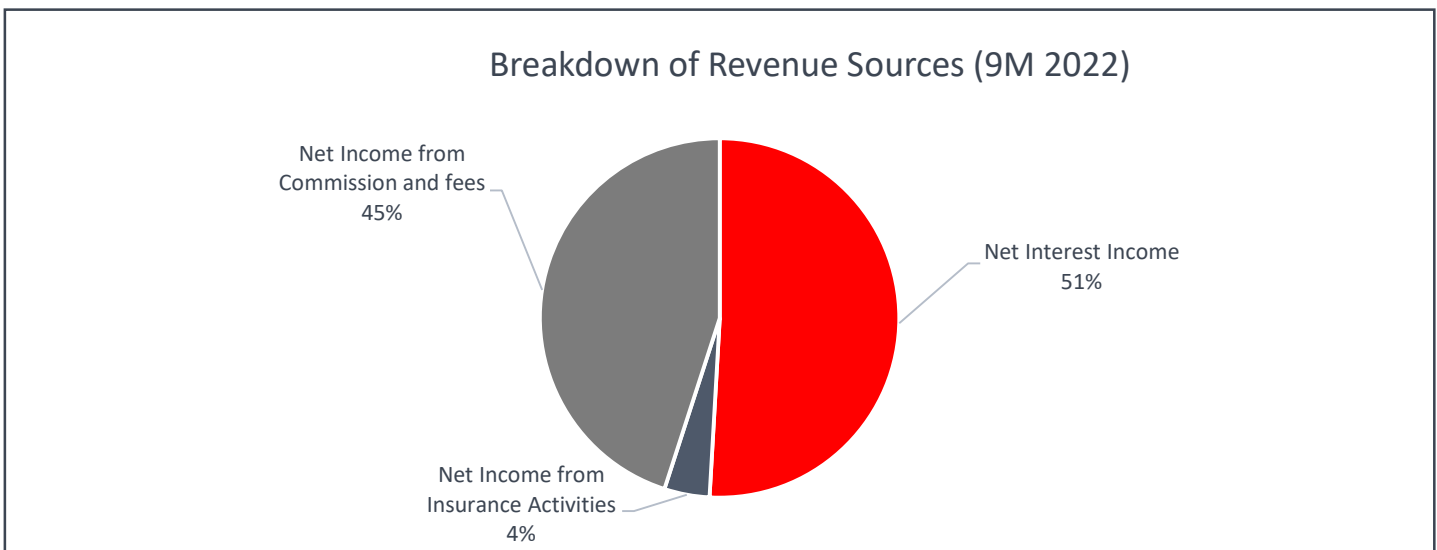
For the nine months ended September 30, 2022 (9M 2022), Total Net Revenue increased by 28.5% or by HNL 1.9 billion when compared to the nine months ended September 30, 2021 (9M 2021). The improvement mainly reflected growth in the Net Interest Income (NIM) segment and growth in Net Income from commissions and fees (services provided), which outweighed the decline in insurance activities. Net Interest Income increased by 50.3% or by HNL 1.8 billion in 9M 2022 when compared to 9M 2021, mainly due to a 19.1% increase in interest income and a 12.3% decrease in interest expense. Higher interest income was mainly driven by a 21.0% increase in interest on loans as a result of an increase in the loan volumes in local and foreign currency by 37.0% and 14.4%, respectively. The improvement in interest income was also driven by a 3.7% increase in investments in certificates, bonds and other financial assets as well as an 18.2% increase in interest income from financial leases.

³ The lempira is the currency of Honduras

Lower interest expense was driven by a 19.9% (or HNL 515.3 million) decline in interest expense on deposits which outweighed the HNL 91.8 million increase in interest expense on loans obtained from banks. Interest expense on bonds and secured notes outstanding also decreased by 3.7% amid a decrease in interest rates. The Honduran banking industry generally does not set interest rates by reference to a benchmark rate; however, the weighted average interest rates on lempira-denominated assets and liabilities of the Honduran banking industry are slightly influenced by the minimum bid rate that the Central Bank allows for its treasury notes. This reference rate was reduced to 3.0% on November 27, 2020 and has not changed since. The increase in income from commissions and fees can be attributed increased service and product offerings being sold such as the higher volume of loans disbursed and increased income from credit card/debit card fees.

Operating expenses increased by 17.5%, or HNL 1.0 billion during 9M 2022 when compared to 9M 2021, primarily due to a 12.1% increase in staff expenses and a 22.8% increase in general and administrative expenses. Staff expenses increased mainly due to an increase in salaries expense due to salary adjustments and increase in the headcount as well as an increase in provision expenses for bonuses, employer contributions and training activities. General and administrative expenses increased by HNL 757.500 million mainly due to: (i) an increase in various expenses of Banco Atlántida mainly due to increases in commission expenses, loyalty programs expenses, security expenses and incoming fees expenses and other expenses.

The foregoing changes in revenue and expenses resulted in an increase in net profit for INVATLAN to HNL 1.1 billion during 9M 2022, representing an improvement of 72.3% when compared to 9M 2021. When we annualized net income, it resulted in a return on equity of 11.0% which represented a substantial improvement in this metric when compared to annualized ROE of 6.8% during 9M 2021. Moreover, as earnings for INVATLAN return to their pre-pandemic levels, we continue to view the Company's income activities as coming mainly from reliable and stable sources. This is demonstrated by over 95.0% of net revenue being the result of interest income and income from commissions and fees, which tend to be reliably stable over time when compared to other income sources such as trading gains.



Capital: Double-Digit Growth Rates reduce Capitalization Despite higher profitability

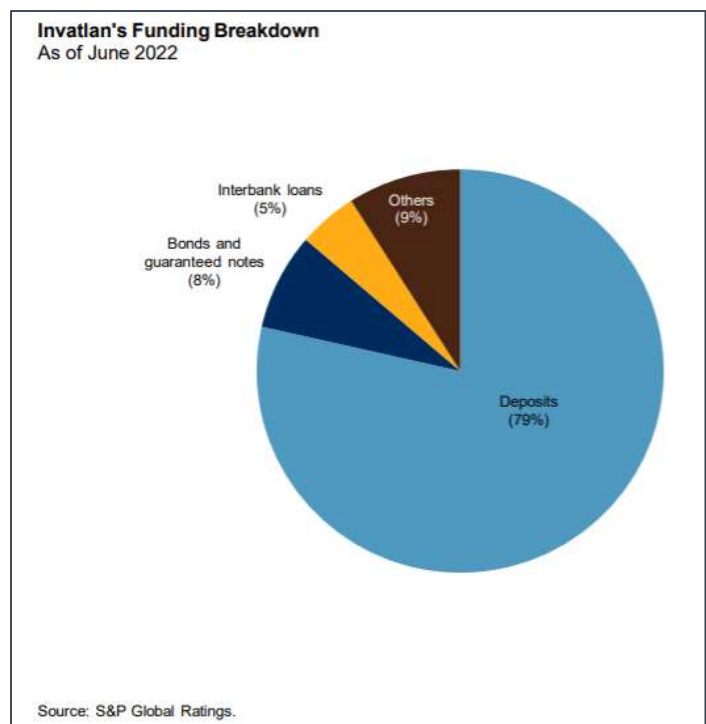
For 9M 2022, our estimates of capital adequacy (Total Equity-to-Total Assets) provided an outturn of 8.8% for INVATLAN. This metric remained stable when compared to the previous year for the same period but formed part of a downward trend when compared to the outturn in previous years (10.4% in 2019; 9.3% in 2020). The decrease has been driven by the rapid growth of its portfolio loan and assets which is outpacing that of internal capital generation, leading to shrinking capitalization ratio over the past few years. If this trend continues, more assets will become increasingly financed by liabilities, which reflects increased risk to the business in terms of ability to withstand any unexpected shocks. INVATLAN'S consistent capital base stems mainly from Banco Atlantida's recurrent internal capital generation, which has representing more than 70% of the group's capital base, according to S&P. S&P expects that INVATLAN'S bottom-line results should increase at double digits in 2022 due to higher business volumes and the recovery of net interest margins (NIMs).

Asset Quality: Remains Adequate Despite High Inflation And Economic Uncertainty In Central America

For 9M 2022, Total Assets grew by 11.8% to HNL 174.1 billion from the HNL 155.7 billion recorded in 9M 2021. As stated earlier, this has been mainly driven by growth in the loan portfolio which increased by 25.3% year-over year. In S&P's view, INVATLAN has ample expertise in risk management, which should enable it to maintain its asset quality in line with historical levels. This is evidenced by a slight uptick in the ratio of non-performing loans to gross loans to 2.5% during 9M 2022 from 2.3% during 9M 2021. S&P also believes that INVATLAN should remain resilient and should cope with the ongoing hits from the global economic shocks with manageable delinquency and credit losses over the next couple of years. Nonetheless, due to the expected persistence of high inflation, market volatility, and rising yields, the outlook indicates increasing challenges for credit in Central America. In this regard, S&P expects Honduran households may struggle with falling real incomes and rising energy and food prices, while demand among some corporate clients to weaken.

Funding And Liquidity: Ample Financial Flexibility And Adequate Liquidity Thanks To A Diversified Deposit Base

INVATLAN'S funding structure relies on that of Banco Atlantida, which has a stable and diversified deposit base, according to S&P. Approximately 79.0% of funding is sourced from deposits and due to this, it is expected that Banco Atlantida should continue benefitting from this sound funding position as a leading deposit-taking institution in Honduras. S&P also believes that INVATLAN'S prudent liquidity management, which cascades across all its subsidiaries, along with its broad deposit base, should help keep liquidity adequate. Likewise, in line with Banco Atlantida's liquidity metrics and based on its broad deposits base, S&P believes the group has a sufficient cushion to cover liquidity needs and wholesale maturities for the next 12 months with manageable liquidity indicators. INVATLAN'S broad liquid asset to short-term wholesale funding was 10.6x as of 2021.





CONCLUSION

We believe INVATLAN's senior secured 7.5% '26 notes offer potential upside given the recent price decline and high yield. The price decline offers an entry opportunity for investors, especially as the Group continues to recover from the impact of the pandemic, supported by stable funding sources and adequate liquidity. Notwithstanding, based on credit rating agency views, INVATLAN may experience some headwinds in the near future as a result of higher economic risks at the level of the sovereign (Honduras).

We therefore recommend that investors participate in these instruments based on their risk appetite as follows:

Appetite for Low Risk: UNDERWEIGHT

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SOURCES

INVATLAN COMPANY WEBSITE, INVATLAN COMPANY FINANCIALS, INVATLAN ANNUAL REPORT, BLOOMBERG, OPPEHNHEIMER & CO., STANDARD & POORS, IMF, INVATLAN Q3 2022 MD&A REPORT

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DEFINITIONS

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.
- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.
- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.