

## First Read

# Banregio

## 2Q16 confirms quality growth; strong beat due to trading and lower provisions

### 2Q16 net income of Ps611mn, 32% above UBSe (Ps462mn)

Net income of Ps611mn grew +22%qoq (+41%yoy), above consensus (Ps552mn). ROE was 21.0% in 2Q16 (17.8% in 1Q16, 17.3% in 2Q15). If we normalize trading, earnings would still have been 20% above UBSe, driven by better asset quality. **Positives:** strong loan and funding growth (27%/26% resp.), better asset quality (NPL ratio at 1.5%) leading to lower provisions. **In line:** cost to income was strong at 45% despite high opex growth of 22%yoy, NIM remained high due to lower repos at 5.3% (1Q16: 5.2%). We expect a positive market reaction. Banregio is our top pick among small caps in Mexico.

### Pivotal questions revolve around SME finance growth and margins

Loan growth was 27%yoy (vs 27%yoy in 1Q16), while the NPL ratio improved to 1.5% (1.7% in 1Q16, 1.5% in 2Q15). The coverage ratio increased to 148% (142% in 1Q16), with the cost of credit decreasing to 0.2% (0.7% in 1Q16, 0.8% in 2Q15). Deposits continued to grow strongly at 26%yoy, driven by low-cost demand deposit growth (funding cost of 3.2%). The NIM reached 5.3% (vs. 5.2% in 1Q16, 4.2% in 2Q15), due to lower repos. Opex grew 22%yoy, with a cost-to-income of 45% (47% in 1Q16). The tax rate was flat at 28%. The Tier I ratio decreased 30bps to 12.5%.

### Growth potential intact; UBSe: ROE of 17.1% in 2016

We expect loan growth of 22%, with margins at 5.2%. The cost-to income ratio should be close to 47%, with asset quality at 1.7%, a coverage ratio of 142%, and a tax rate of 26%, leading to ROE of 17.1%. Operating trends at Banregio point to sustained earnings growth in the high-teen level and we see upside risk to consensus.

### Valuation: Buy; PT Ps115, based on residual income

We like the company's expertise in SME lending (86% of its loan book) and strong management. The SME finance segment presents a strong potential and Banregio appears well positioned. **Risks to the downside:** asset quality, cost efficiency. Banregio trades on 17x 2016E PE and 2.8x PBV vs. 15x/2.0x for Mexican banks.

## Equities

Americas  
Diversified Financial

12-month rating

Buy

12m price target

P115.00

Price

P106.74

RIC: GFREGIOO.MX BBG: GFREGIO MM

### Trading data and key metrics

52-wk range	P107.76-81.74
Market cap.	P35.0bn/US\$1.90bn
Shares o/s	328m (COM)
Free float	26%
Avg. daily volume ('000)	443
Avg. daily value (m)	P45.2
Common s/h equity (12/16E)	P12.4bn
P/BV (12/16E)	2.8x
Tier 1 ratio	12%

### EPS (UBS, diluted) (P)

	UBS	Cons.
12/16E	6.11	6.39
12/17E	6.88	7.55
12/18E	8.01	8.58

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Figure 1: 2Q16 Earnings – main highlights

Source: Company, Bloomberg, UBS

P\$ mn	Consensus	2Q16a	2Q16e	1Q16a	2Q15a	QoQ	YoY	A vs E	A vs Cons
NIM		5.3%	5.3%	5.2%	4.2%	13 bps	108 bps	2 bps	
NPL		1.5%	1.7%	1.7%	1.5%	-15 bps	6 bps	-17 bps	
C/I		45.3%	49.1%	46.8%	46.0%	-151 bps	-71 bps	-378 bps	
Net income	551.8	611.0	462.4	501.0	434.0	22.0%	40.8%	32.1%	10.7%
<b>Highlights (Pm)</b>		<b>12/13</b>	<b>12/14</b>	<b>12/15</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>	<b>12/19E</b>	<b>12/20E</b>
Revenues		4,084	4,803	5,356	6,229	7,152	8,182	9,096	10,030
Profit before tax		1,884	2,223	2,315	2,724	3,047	3,549	4,106	4,623
Net earnings (local GAAP)		1,433	1,644	1,782	2,003	2,255	2,626	3,038	3,421
Net earnings (UBS)		1,433	1,644	1,782	2,003	2,255	2,626	3,038	3,421
Tier 1 ratio %		12.1	13.1	12.2	11.8	11.7	11.8	12.1	12.5
EPS (UBS, diluted) (P)		4.37	5.01	5.43	6.11	6.88	8.01	9.26	10.43
<b>Profitability/valuation</b>		<b>12/13</b>	<b>12/14</b>	<b>12/15</b>	<b>12/16E</b>	<b>12/17E</b>	<b>12/18E</b>	<b>12/19E</b>	<b>12/20E</b>
ROE (UBS) %		18.9	18.8	17.3	17.1	17.1	17.8	18.3	18.3
P/POP (diluted)		11.1	9.3	10.0	10.6	9.2	7.8	7.0	6.3
P/BV x		2.9	2.6	2.6	2.8	2.5	2.2	2.0	1.8
P/BV (UBS) x		2.9	2.6	2.6	2.8	2.5	2.2	2.0	1.8
P/E (UBS, diluted)		16.2	15.0	15.8	17.5	15.5	13.3	11.5	10.2
Net dividend yield %		1.9	0.0	0.0	1.7	2.3	2.6	3.0	3.4

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of P106.74 on 25 Jul 2016 16:44 EDT

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**Forecast returns**

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Forecast price appreciation	+7.7%
Forecast dividend yield	1.7%
Forecast stock return	+9.4%
Market return assumption	9.8%
Forecast excess return	-0.4%

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**Valuation Method and Risk Statement**

Our Banregio price target is Residual Income Model derived, with a CoE of 10.3%, sustainable ROE of 18.0% and growth of 6.0%.

Latin American banks can be affected by changes in both global and local economic conditions and are also subject to political, interest rate, and foreign exchange risks. Our price targets are highly dependent on the level of country risk.

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Buy	FSR is > 6% above the MRA.	47%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	25%
Sell	FSR is > 6% below the MRA.	15%	21%
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Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 30 June 2016.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
<b>Banregio</b> <sup>7, 16</sup>	GFREGIOO.MX	Buy	N/A	P106.40	22 Jul 2016

Source: UBS. All prices as of local market close.

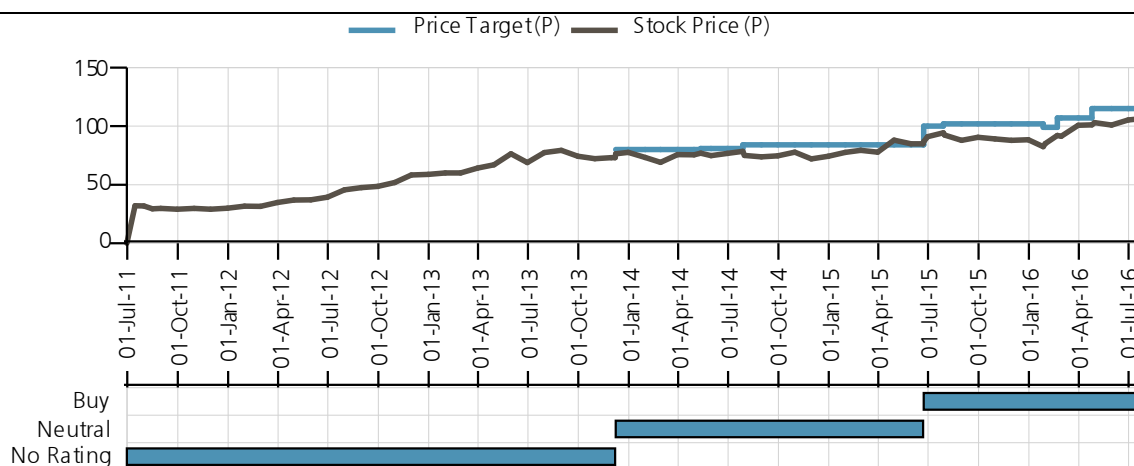
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## Banregio (P)



Source: UBS; as of 22 Jul 2016

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