

banregio

Regional Valuation

Dic 11 2021

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BUSINESS AND BACKGROUND INFORMATION

Setting and Background Information

The origin of Regional starts with the founding of Banco Regional in 1994. Banco Regional was founded by a group of investors, headed by Jaime Rivero Santos and Manuel G. Rivero Santos, with an investment of \$56 million USD, roughly \$100 million USD today.

During its first years, the objective of the bank was to consolidate itself and gain market share in Nuevo León. In 1997 the bank began an expansion strategy and started opening branches across the city of Monterrey. That same year, Inmobiliaria Banregio, a subsidiary of the bank, was created with the focus on developing and managing the development of the bank's branches and offices. In 1998, after establishing its presence in the city of Monterrey, the bank decided to open its first branch outside the state of Nuevo León in the city of Saltillo, Coahuila.

In 2000, the bank created Sinca Banregio, a subsidiary dedicated to real estate projects, operating with businesses that need long term financing. In 2001, the bank created Factor Banregio, a subsidiary of the bank focused on financial factoring. That same year the bank created Operadora Banregio, a subsidiary of the bank dedicated to managing investments from third parties.

In 2002, with the goal of diversifying the operations of the bank, the bank acquired Arrendadora Financiera del Norte, now called Start Banregio. Arrendadora Banregio is a subsidiary focused on leasing, mainly auto.

In 2008 Factor Banregio was renamed Vivir Soluciones Financieras, continuing as a subsidiary of Banregio, but now with a focus on consumer lending.

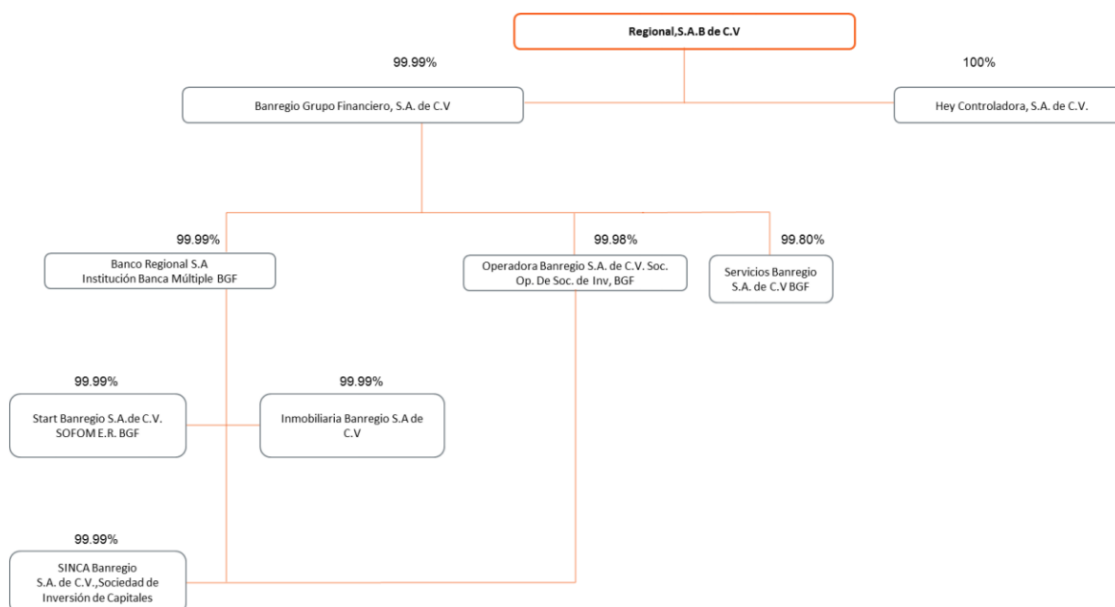
In December 2009, Banregio acquired 100.0% of Masterlease, a leading company in pure vehicle leasing in Mexico, with offices in the Federal District, Guadalajara and Monterrey, with more than \$ 1,500 million pesos or \$75 million USD in assets. The objective of this acquisition was to strengthen Banregio's product offering in the vehicle leasing market to small, medium, and large enterprises.

In July of 2011, Banregio Grupo Financiero realized its initial public offering in the Bolsa Mexicana de Valores

In 2014, through its subsidiary, Start Banregio, Banregio Grupo Financiero acquired The Capita Corporation de México, subsidiary of CIT Equipment Financing in México, dedicated to the leasing of equipment.

In August 2016, the board of Banregio Grupo Financiero decided to restructure the company in which Banregio Grupo Financiero became a subsidiary of Regional, a new company. Banregio Grupo Financiero currently represents 99.9% of the operation and Banco Regional produces 80% of the accumulated net profit.

ESTRUCTURA CORPORATIVA



Through its subsidiaries, Regional offers a wide variety of financial products and services. Of the net income of \$3,675 million pesos at the end of 2019, Banregio Grupo Financiero, its main subsidiary, generated \$3,670 million pesos.

The principal activity of Regional is the loaning of commercial credit, which currently represents 83% of their total loan portfolio. Regional's operations are divided as follows: offering of financial services to medium and small enterprises, leasing, private banking, mortgage, consumer credit, and intermediary related activities.

In 2019, offering of financial services to medium size enterprises represented 69% of Regional's loan portfolio, and 16% of its funding. This business unit also generated 40% of Regional's revenue.

Offering and financial services to small enterprises represented 17% of Regional's total loan portfolio, and 13% of its funding. This business unit generated 26% of Regional's revenue.

In regards to Regional's leasing business, Regional offers credit and pure leasing for the acquisition of vehicles to consumers and enterprises. This type of financing always counts with the guarantee of the assets financed or leased. As of December 31, 2019, Start Banregio had \$17,157 million pesos in assets and at the end of December 2018 it had \$16,559 million pesos in assets.

Regional's private banking business segment is focused on attending consumers. In 2019, this unit represented 36% of Regional's funding, and generated 16% of its revenues.

The mortgage business segment of Regional is focused on providing financing for the acquisition of real estate related activities to consumers with or without business activity. Clients

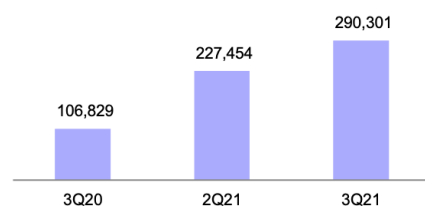
can access financing with terms ranging from 1 year to a maximum of 20 years; this type of credits are amortizable and always have the real guarantee on the real estate funded. Loans are offered in Pesos at a fixed or variable rate. In 2019, this segment amounted to 10% of Regional's total loan portfolio, and 4% of its revenues.

The consumer lending business segment offers products like credit cards and personal loans to medium-high income people. In 2019, this unit represented 2% of Regional's total loan portfolio and 2% of its revenues.

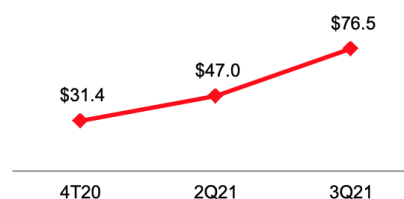
The intermediary related activities business segment offers money market funds, currency changes and investment fund distribution services. Regional's money market funds are primarily focused on short, medium and long term financial instruments issued by the Federal Government, banking institutions and companies. In 2019, this business segment represented 34% of Regional's funding and 11% of its revenues.

As of this date, there is no borrower or group of borrowers who, individually, represents 10% or more of the total portfolio. These figures are estimated to represent a low concentration of borrowers and high diversification in the source of payment for the portfolio of credit.

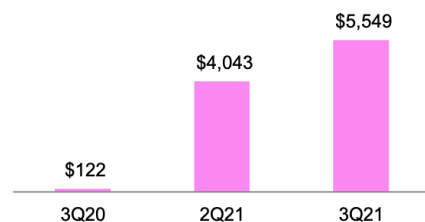
Additionally, HeyBanco is a digital bank focused on consumer lending catered to individuals and individuals with business activities, some products include: checking and savings accounts, credit cards, and auto-insurance. Currently, Hey Banco has more than 290k active users. The number of transactions in 3Q21 reached 8.8 million for an amount greater than \$13,004 million pesos. Deposit in 3Q21 reached \$5,549 million pesos. And loans in 3Q21 reached \$900 million pesos. As of September 2021, the monthly income per active user is \$76.5 and cost to serve is \$ 12.9 MXN, which gives us a projected lifetime value of \$3,816 pesos. Finally, the acquisition cost per user is \$100 pesos.



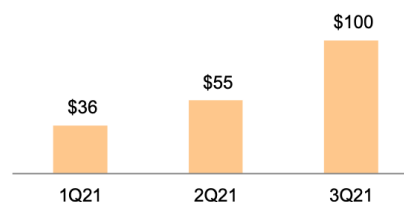
Active Users



**Monthly Income per User
(Quarterly average)**



Deposits (MXN Millions)



Quarterly CAC per Active User (MXN)

Overall, in Q3 2021, Regional had more than 409,991 active clients and its total loan portfolio amounted to \$115,265 million pesos. Regional also had \$6,072 million pesos worth of leasing equipment. With total assets of \$164,851. On the other hand, Regional had \$114,434 million pesos in total funding excluding repurchase agreements, and \$23,508 million pesos in equity. As of Q3 2021, net income has been \$2,631.

The bank currently has 156 branches in 22 different states across Mexico. This includes: Aguascalientes, Baja California, Baja California Sur, Chihuahua, Ciudad de México, Coahuila, Durango, Estado de México, Guanajuato, Jalisco, Michoacán, Nuevo León, Puebla, Querétaro, Quintana Roo, San Luis Potosí, Sinaloa, Sonora, Tamaulipas, Veracruz, Yucatán y Zacatecas. 58 of the branches are in Nuevo León, 13 in Jalisco, 8 in México City and 76 in the rest of the states. Additionally, there are 8 exchange centers, 3 new contact modules known as Punto Naranja * and one Preferential branch. As well as 308 ATMs and more than 21,000 point-of sale-terminals. Of the 156 branches that Regional had at the end of 2019, 155 were leased with contracts of lease with an average term of up to 10 years and renewable for periods undefined.

Profitability

Since its founding, Regional has been a very profitable bank. From 2008 to 2019 earnings per share grew at an average rate of 19% annually. Equally important, Regional's equity has grown at a compounded annual rate of 23.2% since 1994. Even with dividend payments totaling \$3,178 million pesos, that represents 1,765% the value of the initial investment in 1994 of \$180 million pesos.

Additionally, margins have been high and consistent. From 2015 to 2020, operating margins were between (23.2% - 34%), net interest margins were from (5.60%-7.00%), returns on equity were from (13.3% - 18.6%), and returns on assets were from (1.8%-2.7%).

(in Millions of Mexican Pesos)

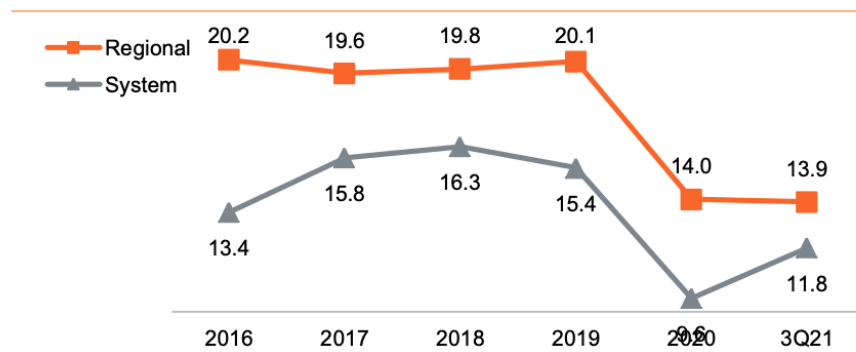
Year	9M21	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
Interest Income	9,784	15,251	17,027	14,370	11,564	8,240	8,399	7,487	7,155	6,329	5,313
Interest Expense	4,238	7,739	9,326	7,381	5,417	3,002	3,761	3,674	3,762	3,289	2,864
Net Interest Income	5,546	7,512	7,701	6,989	6,147	5,238	4,638	3,813	3,393	2,848	1,951
Provisions for Losses	593	1,064	731	716	685	368	516	422	211	192	498
Non-Interest Income	2,123	2,412	2,469	2,073	1,787	1,625	718	990	691	803	1,132
Total Operating Revenue	11,907	17,663	19,496	16,443	13,351	9,865	9,117	8,477	7,846	7,132	6,445
Non-Interest Expense	3,493	4,747	4,334	3,924	3,404	3,139	2,532	2,167	1,991	1,967	1,704
Total Operating Expenses (with provisions)	8,324	13,550	14,391	12,021	9,506	6,509	6,809	6,263	5,964	5,448	5,066
Net Operating Income (After Provisions)	3,583	4,113	5,105	4,422	3,845	3,356	2,308	2,214	1,884	1,684	1,379
Operating Margin	30%	23.2%	26.2%	26.9%	28.8%	34.0 %	25.3 %	26.1%	24%	23.6%	21.3%
Total Net Income	2,631	2,952	3,675	3,197	2,758	2,411	1,785	1,644	1,433	1,203	1,054
Net Income Margin	22%	16.7%	18.8%	19.4%	20.6%	24.4 %	19.6 %	19.4%	18.3%	16.9%	16.3%

Profitability Key Ratios

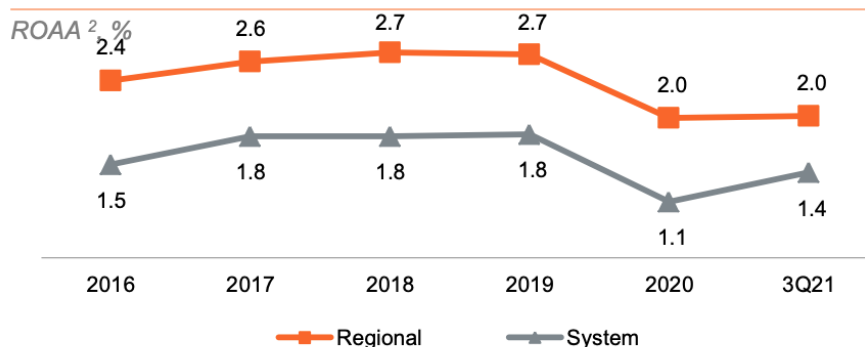
Year	Q3 2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
NIM	5.8%	5.9%	6.2%	6.5%	6.3%	5.6%	5.5%	6.3%			
ROE	13.9 %	13.3 %	18.6 %	18.1 %	18%	17.6 %	16.2 %	17.2 %	18%	16.6 %	16.8%
ROA	2.0%	2.0%	2.6%	2.5%	2.6%	2.4%	1.8%	1.6%	1.5%	1.5%	1.6%

In regards to Regional's performance vs the industry and competitors, the company has maintained a high profitability index compared to the Mexican Financial System. The ROAE for 2019 was 20.1%, which is higher than the 16.1% posed by the Mexican Financial System. Likewise, Regional's ROAA for 2019 was 2.7%, compared to the 1.8% achieved by the industry.

ROAE¹

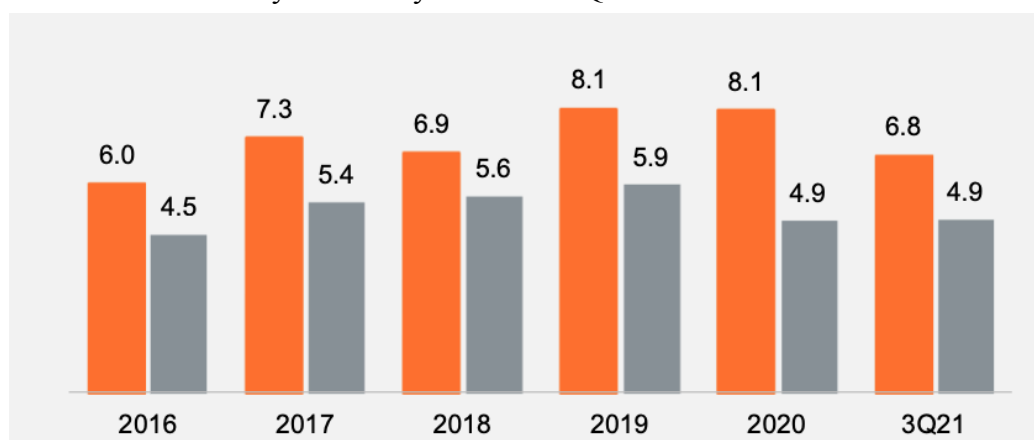


Return on Average Equity of Regional vs Industry



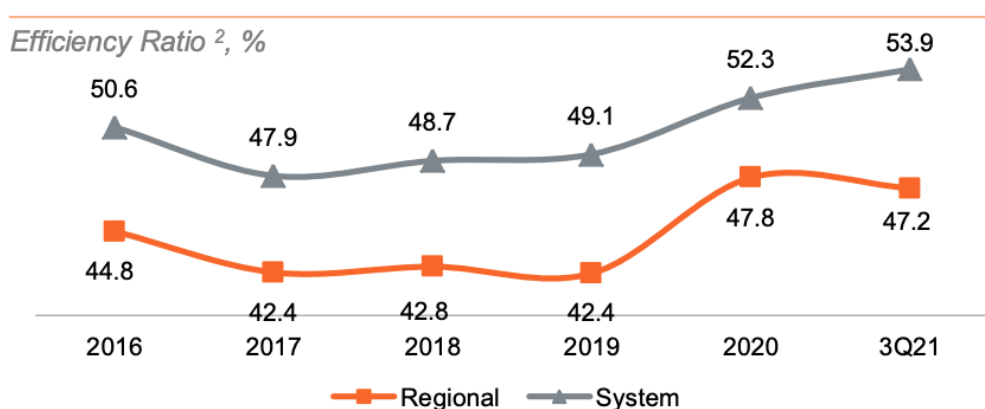
Return on Average Assets of Regional vs Industry

These results have been possible thanks to Regional's **relationship-based model**, which allows the company to achieve better than average financial margins on its commercial loans than the industry. The graph below displays the Financial Margin of Regional's Commercial Loan Portfolio vs the industry from the year 2015 to Q3 2020.



Financial Margin of Commercial Loan Portfolio of Regional (orange) vs industry (grey)

Equally important in helping Regional achieve these results has been its ability to expand its commercial loan portfolio without the need of a large branch network. Regional currently only has 156 branches in 22 different Mexican States, with a market share of 5% and 6% in loans to small and medium sized companies, respectively. In effect, Regional's limited branch network has allowed the company to be one of the most efficient banks in the Mexican Industry. Below are two tables showcasing Regional's efficiency ratio vs the industry and competitors.



Regional's Efficiency Ratio vs Competitors

Regional vs Competitors as of September 2020

Bank	Number of Branches
BBVA Bancomer	1859
Banorte	1182
Santander	1045
Banamex	1465
HSBC	951
Scotiabank	553
Inbursa	883
Bajio	295
Banregio	156

<https://www.statista.com/statistics/1114454/mexico-number-branches-banks/>

Number of Branches of Selected Banks

Even though Regional does not have a massive big branch network, it still has a competitive cost of funding relative to its competitors (see table below for more detail). While at the same time being one of the top 5 most profitable banks thanks to its efficiency and greater financial margin on commercial loans.

Cost of Funding

The table below shows Regional and the General Mexican Banking System's cost of funding from 2015-2019.

Cost of Funding for the Regional

Year	Q3 2021	2020	2019	2018	2017	2016	2015
Cost of Funding	2.83%	3.4%	4.8%	5.1%	n/a	2.4%	1.9%

Cost of Funding for the General Mexican Banking System

Year	Q3 2021	2020	2019	2018	2017	2016	2015
Cost of Funding	2.1%	2.5%	4.0%	4.0%	3.6%	2.7%	1.77%

The main reason why Regional's cost of funding has been greater than the industry average is that it does not have a large branch network relative to bigger banks such as BBVA and Banorte. Which makes it harder for Regional to obtain deposits of immediate demand—in Q1 2021 only 40% of Regional's funding were deposits of this kind. In effect, Regional has needed to fund itself mainly through time deposits, which are more expensive. Currently, the average cost of time deposits for Regional is 4.27%, compared to just 1% for deposits of immediate demand. Likewise, Regional's use of debt as a funding source increases its cost of funding. The cost of debt for Regional is currently 4.60% in the debt market and 5.85% in development banks.

Funding Structure

Notes:

- Total Funding = Demand Deposits + Time Deposits + Total Debt + Repos
- Total Core Deposits = Demand Deposits + Time Deposits

Total Funding for Regional from 2015 to 2021 (in millions)

Year	Q3 2021	2020	2019	2018	2017	2016	2015
Total Funding	133,316	121,034	116,629	106,573	93,971	85,938	89,592

Total Core Deposits of Regional from 2015 to 2021 (in millions)

Year	Q3 2021	2020	2019	2018	2017	2016	2015
Core Deposits	106,491	99,822	99,718	88,891	78,539	64,592	56,011
% of Total Funding	80%	83%	86%	83%	84%	75%	63%

Capitalization and Leverage

Regional has maintained a healthy level of capitalization. The table below shows Regional's equity to assets minus cash and cash equivalents ratio from 2015-2021.

Equity to Assets Ratio FY 2020

Year	Q3 2021	2020	2019	2018	2017	2016	2015
Equity to Assets Ratio	14.2%	16.0%	14.8%	14.8%	14.7%	13.4%	11.2%

Additionally, the table below shows Regional's capitalization compared to the industry and competitors as of September 2020. You may notice that Regional's capitalization of 15.5% is lower than the market average of 18.3%. This is due to the quality of Regional's loan portfolio. Regional's percentage of non performing loans of small and medium size business loans are 4% and 0.9%, compared with a market average of 4.2% and 2.9%, respectively.

Commercial Banking	Total Loan Portfolio	Core Deposits ⁵	Shareholders Equity	ROE	Efficiency	Capitalization ⁶	Cost of Funding	TDA ⁷	ICOR
BBVA	1,277	1,376	301	19.7%	36.6%	18.1%	1.4%	5.8%	1.5
BANORTE	823	761	237	14.0%	44.6%	21.5%	1.9%	3.3%	1.7
SANTANDER	716	764	166	8.6%	49.4%	19.5%	1.9%	6.3%	1.2
CITI	531	861	219	9.9%	64.7%	17.2%	1.3%	6.7%	2.4
SCOTIABANK	418	376	69	14.3%	49.7%	14.8%	3.6%	4.6%	1.0
HSBC	379	462	72	1.6%	71.2%	14.4%	2.4%	5.5%	1.5
INBURSA	242	187	168	10.6%	36.9%	19.3%	4.5%	4.3%	2.2
BAJIO	196	182	36	11.3%	50.3%	17.9%	3.0%	1.7%	2.0
SABADELL	118	52	19	(0.8%)	73.8%	15.1%	4.7%	0.9%	1.3
BANREGIO	115	106	24	13.9%	47.2%	15.5%	2.7%	2.1%	1.4
MIFEL	55	41	9	9.9%	56.5%	13.6%	4.2%	4.5%	0.7
AFIRME	55	62	12	10.0%	67.2%	16.0%	3.1%	5.6%	1.3
MULTIVA	53	46	7	0.2%	80.0%	17.0%	4.6%	3.8%	0.8
VE POR MAS	51	39	7	9.5%	61.6%	12.9%	4.4%	3.7%	1.0
BANSI (B)	21	20	4	16.2%	46.4%	17.2%	4.2%	2.4%	2.7
BANCREA	17	13	2	6.0%	76.3%	15.6%	4.9%	0.5%	2.8
FINTERRA	2	0	0	(19.4%)	218.9%	16.4%	6.5%	22.9%	0.5
TOTAL	\$5,069	\$5,350	\$1,351	11.8%	49.6%	18.3%	2.2%	4.9%	1.6

The following table shows Regional's leverage by comparing its liabilities to its equity for the years 2015 to 2021.

Liabilities to Equity Ratio

Year	Q3 2021	2020	2019	2018	2017	2016	2015
Liabilities to Equity Ratio	6	5.76	6.2	6.3	6.3	6.8	8.5

As you can see, Regional has been deleveraging itself these past years thanks to recurring profit generation. The increase in equity in 2020 was mainly due to the extra capital buffer that the

company has put, derived from the postponing of dividends and lower portfolio loan growth, in place to maintain a healthy liquidity due to the pandemic.

Likewise, Regional has generally been increasing its deposit base in relation to its total loan portfolio since 2015, as shown in the first table below. Although currently Regional's loan portfolio is more overextended relative to its core deposits than the industry average, as shown in the second table below. I think that Regional has been able to maintain this Loan to Deposit ratio thanks to the quality of its loan portfolio. As mentioned above, Regional's percentage of non performing loans of small and medium size business loans are 4% and 0.9%, compared with a market average of 4.4% and 2.6%, respectively.

Total Loan Portfolio to Deposit Ratio of Regional for FY 2015 to FY 2020

Year	Q3 2021	2020	2019	2018	2017	2016	2015
Loan Portfolio to Deposit Ratio	108%	110%	108%	111%	113%	123%	120%

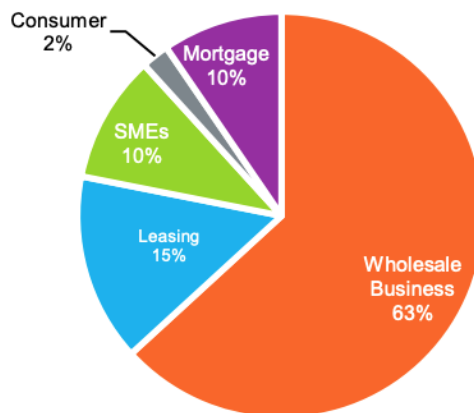
Loan to Deposit Ratio of Regional vs the Industry and Competitors as of September 2020

Bank	Loan to Deposit Ratio
BBVA Bancomer	97%
Banorte	104%
Santander	95.3%
Banamex	70.6%
HSBC	88%
Scotiabank	115%
Inbursa	138%
Bajio	112%
Regional	113%
Industry	98%

Quality of Loan Portfolio

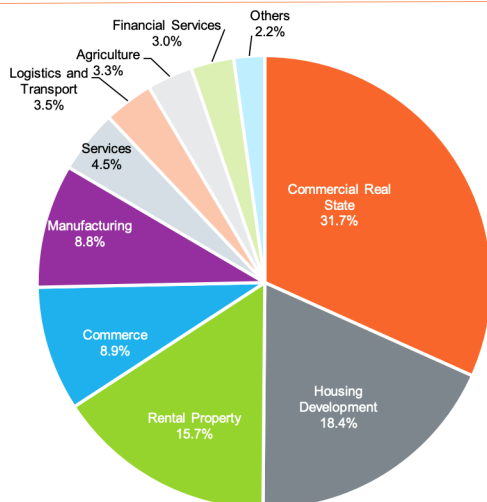
Touching more on Regional's loan portfolio quality, currently the company has a performing loan portfolio of \$113,352 million pesos that's divided mainly into 2 different segments, wholesale banking (Medium size business loans that are greater than > \$30 million MX) and retail banking (Small Businesses loans that are between \$12 and \$30 million MXN , and Preferred Banking). The diagram below shows how Regional's loan portfolio is divided among these segments in 2019 and 2020.

As of Q3 2021, medium size business loans were 63% of the total loan portfolio. Small business loans were 15% of the total loan portfolio. Mortgage consumer loans were 10% of the total loan portfolio. Consumer loans were 2% of the total loan portfolio.

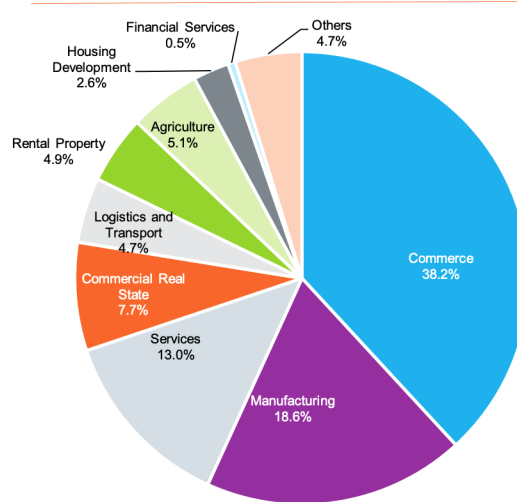


Additionally, the following diagrams show Regional's commercial portfolio by segment in Q3 2021.

Wholesale



Retail Banking



On the same note, the following table shows Regional's NPL by segment in Q4 2020.

	3Q20	4Q20	1Q21	2Q21	3Q21
Wholesale Business	0.6%	0.6%	0.8%	0.7%	0.9%
Retail Banking	4.6%	4.7%	5.5%	5.1%	5.3%
Auto Loans	1.0%	1.3%	1.5%	1.4%	1.3%
Mortgage	2.3%	2.7%	2.9%	2.8%	2.7%
Consumer	1.2%	3.9%	5.7%	3.4%	2.3%
Regional's NPL ratio	1.2%	1.4%	1.7%	1.6%	1.7%

The tables below also show the percentage of Regional's non-performing loans for small and medium size loans for the years 2015-2020 vs the Mexican Banking Industry.

Percentage of Non-Performing Loans of Small Size (100k - 10M*) for Regional

Year	2020	2019	2018	2017	2016	2015
NPL	2.8%	4.1%	3.3%	2.6%	3.7%	2.2%

* = Mexican Pesos

Percentage of Non-Performing Loans of Small Size for the Mexican Banking System

Year	2020	2019	2018	2017	2016	2015
NPL	4.4%	5%	4.2%	3.7%	3.1%	3.5%

Percentage of Non-Performing Loans of Medium Size (10M - 250M*) for Regional

Year	2020	2019	2018	2017	2016	2015
NPL	0.6%	0.9%	0.9%	0.6%	0.7%	0.5%

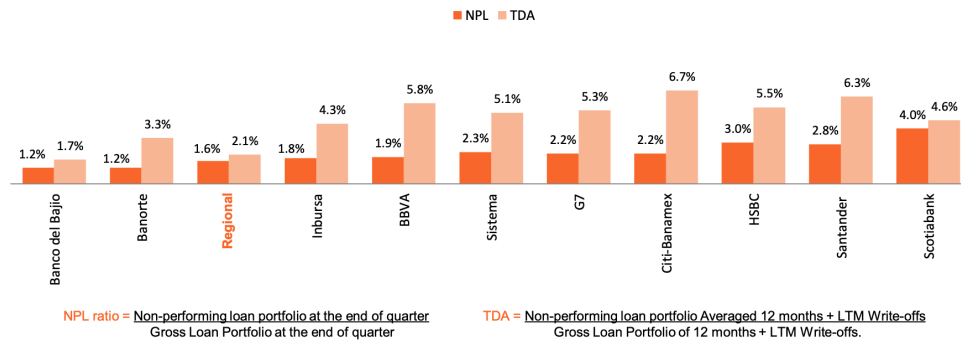
* = Mexican Pesos

Percentage of Non-Performing Loans of Medium Size for the Mexican Banking System

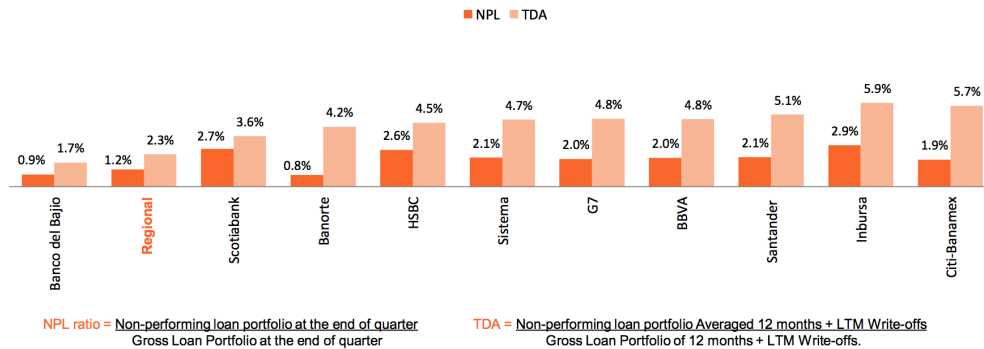
Year	2020	2019	2018	2017	2016	2015
NPL	2.4%	2%	1.6%	1.6%	2.5%	3.1%

In regards to Regional's loan portfolio as a whole, the graphs below show the percentage of Regional's non-performing loans for the years 2015-2020 vs its competitors.

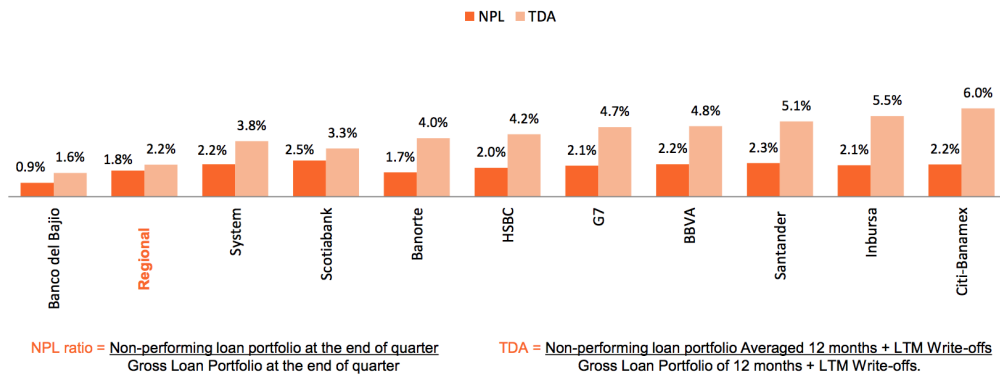
Regional's NPL and TDA Ratio vs Competitors for Q3 2021



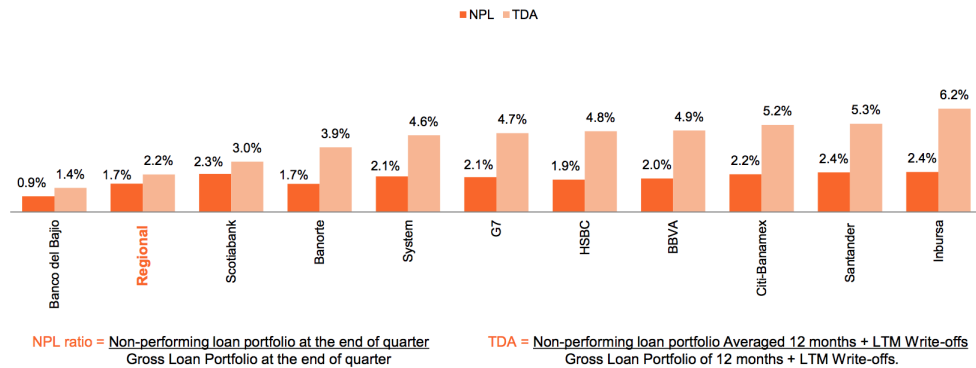
Regional's NPL and TDA Ratio vs Competitors for Q3 2020



Regional's NPL and TDA Ratio vs Competitors for Q3 2019



Regional's NPL and TDA Ratio vs Competitors for Q3 2018



Source: CNBV, September 2018. Comparable Banks. (Banca múltiple, información de la situación financiera) (040-1A-R0). | G7 includes: BBVA Bancomer, Citi-Banamex, Scotiabank, Santander, Inbursa, Banorte y HSBC.

Clearly, Regional's portfolio quality has been consistently better than the market average and most of its competitors. These results comply with our prior statement that Regional has been able to have a higher loan to deposits ratio thanks to the quality of its loan portfolio.

Furthermore, Regional has maintained a healthy level of allowance for credit losses relative to its loan portfolio and non-performing loans. The first two tables show this, while the last two tables show these same ratios for Banco del Bajío and Banorte, two of Regional's main competitors, for the objective of comparison.

Regional's Allowance for Credit Losses to Total Loan Portfolio from 2015 to 2020

Year	Q3 2021	2020	2019	2018	2017	2016	2015
ACL / TLP	2.4%	2.4%	2.2%	2.2%	2.3%	2.3%	2.5%

Banco del Bajío's Allowance for Credit Losses to Total Loan Portfolio from 2015 to 2020

Year	2020	2019	2018	2017	2016	2015
ACL / TLP	2.2%	1.5%	1.8%	1.9%	<i>n/a</i>	<i>n/a</i>

Banorte's Allowance for Credit Losses to Total Loan Portfolio from 2015 to 2020

Year	2020	2019	2018	2017	2016	2015
ACL / TLP	2.5%	2.3%	2.4%	2.6%	2.5%	2.6%

Regional's Allowance for Credit Losses to Non-Performing Loans from 2015 to 2020

Year	Q3 2021	2020	2019	2018	2017	2016	2015
ACL / NPL	143%	169%	122%	130%	140%	146%	156%

Banorte's Allowance for Credit Losses to Non-Performing Loans from 2015 to 2020

Year	2020	2019	2018	2017	2016	2015
ACL / NPL	224%	138%	142%	130%	139%	116%

Banco del Bajío's Allowance for Credit Losses to Non-Performing Loans from 2015 to 2020

Year	2020	2019	2018	2017	2016	2015
ACL / NPL	205%	155%	187%	230%	<i>n/a</i>	<i>n/a</i>

Concentration of Loan Portfolio in Principal Clients

Regional's loan portfolio is very well diversified among clients. In December 2019, the amount of loans given to the 10 principal debtors represented \$5,196 million pesos, which corresponds to 5% of the total loan portfolio. Currently there is no client that individually represents 10% or more of the total loan portfolio.

Credit Rating

Since 2015, Regional has maintained an investment grade credit rating by Fitch.

Regional's Credit Rating by Fitch from 2015 to 2020

Year	Q3 2020	2020	2019	2018	2017	2016	2015
Credit Rating	AA-(mex))	AA(mex)	AA+(mex))	AA+(mex))	AA+(mex))	AA+(mex))	AA(mex)

Human Capital

At the end of 2019, Regional had 5,007 employees, 675, 13%, of which were unionized.

Corporate Structure and Governance

Directors

Principales Funcionarios

Presidente del Consejo de Administración Regional Lic. Manuel G. Rivero Santos	Director General Regional Lic. Manuel G. Rivero Zambrano	Director General Banco Regional Lic. Héctor Cantú Reyes
Asesor de Proyectos Inmobiliarios y Director SINCA Ing. Enrique Navarro Ramírez		
D.G.A. de Banca Lic. Javier González Caballero	D. de Finanzas y Planeación Ing. Enrique Navarro Ramírez	D.G.A. de Gestión de Riesgo Lic. Ramiro G. Ramírez Garza

Board of Directors:

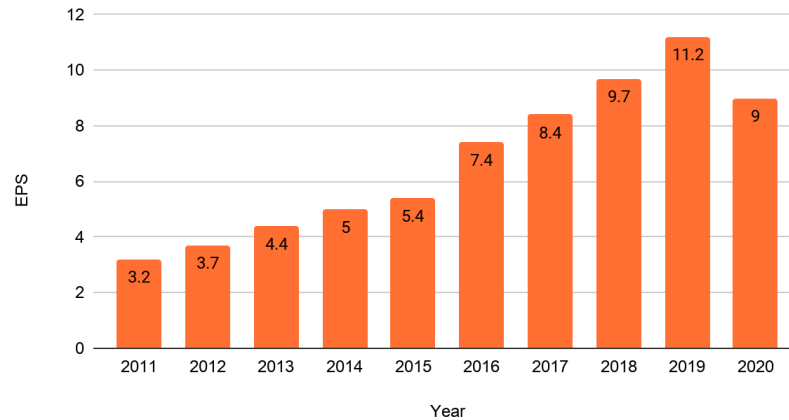
Patrimonial	Independent
Jaime Alberto Rivero Santos (II)	Francisco Rogelio Garza Eglooff
Manuel G. Rivero Santos (I)	Alfonso González Miyoga
Manuel G. Rivero Zambrano	Jorge Humberto Santos Reyna
Sergio Eugenio González Barragán	Isauro Alfaro Álvarez
Héctor Cantú Reyes	Oswaldo José Ponce Hernández
Alejandra Rivero Roel	Juan Carlos Calderón
Marcelo Zambrano Lozano (Alternativo)	Daniel A. Abut
	Carlos Arreola Enríquez
	Luis Miguel Torre Amione

- 64% of board members are independent
- Salaries, year-end bonuses, and performance bonuses, are given in cash.

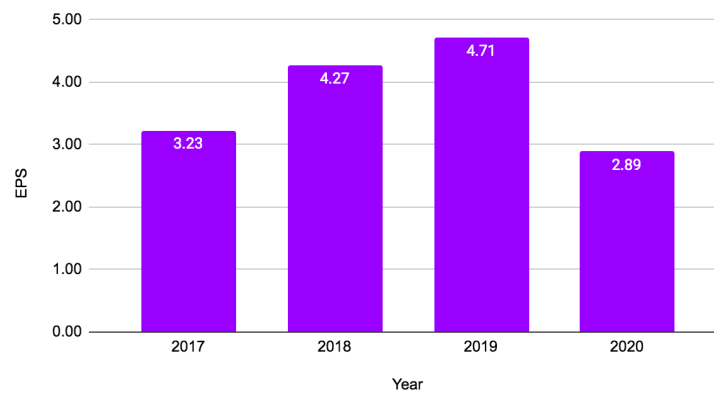
Market Valuation of Regional vs Competitors

Earnings per Share of Regional vs Banorte vs Banco del Bajío

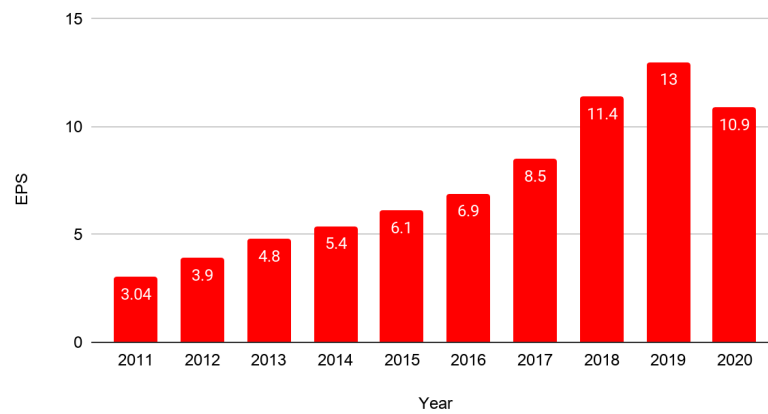
Regional's Earnings per Share



Banco del Bajío's EPS

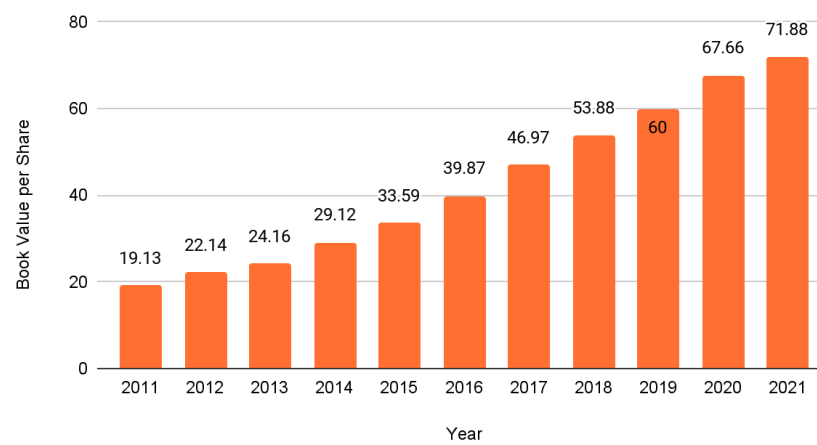


Banorte's EPS

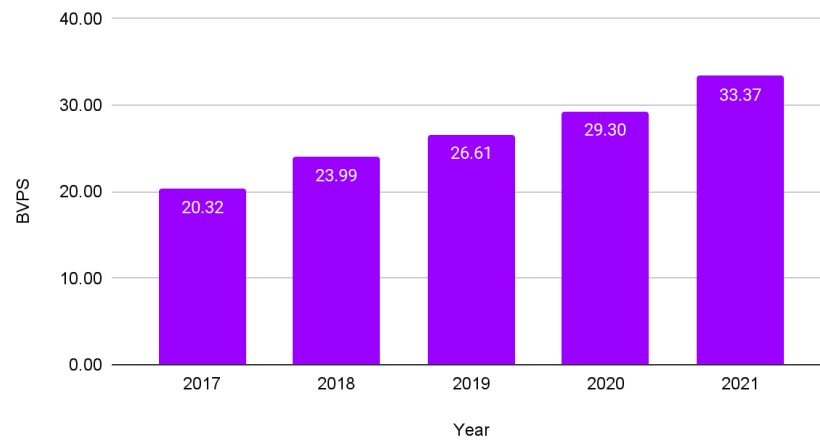


Book Value per Share of Regional vs Banorte vs Banco del Bajío

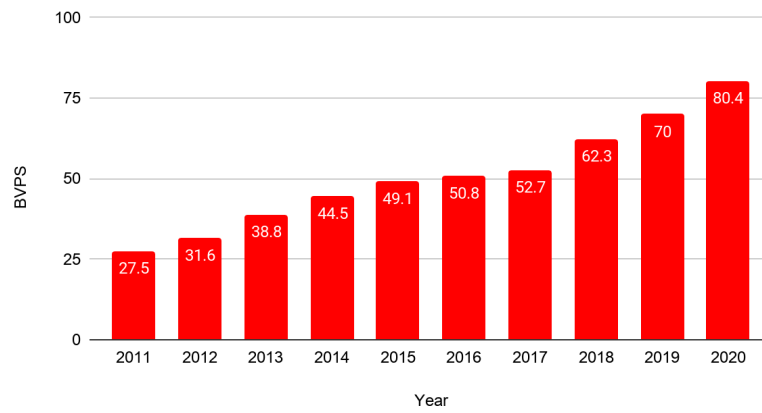
Regional's BVPS



Banco del Bajío's BVPS

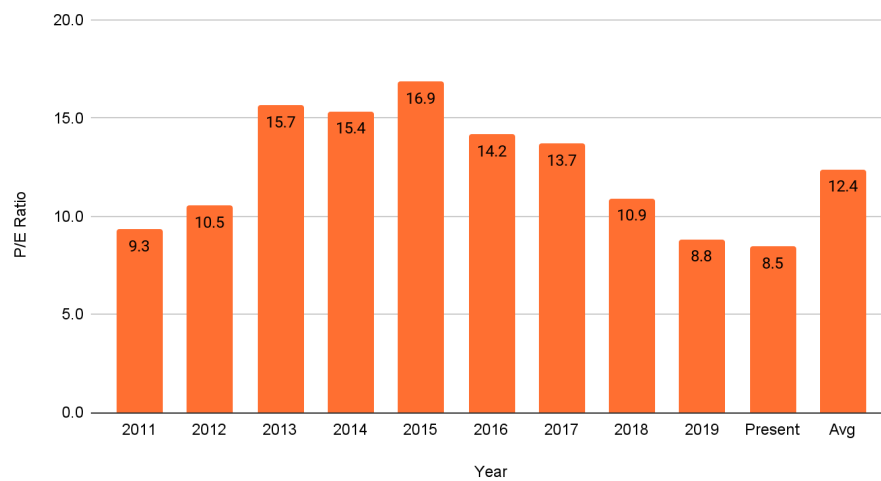


Banorte's BVPS

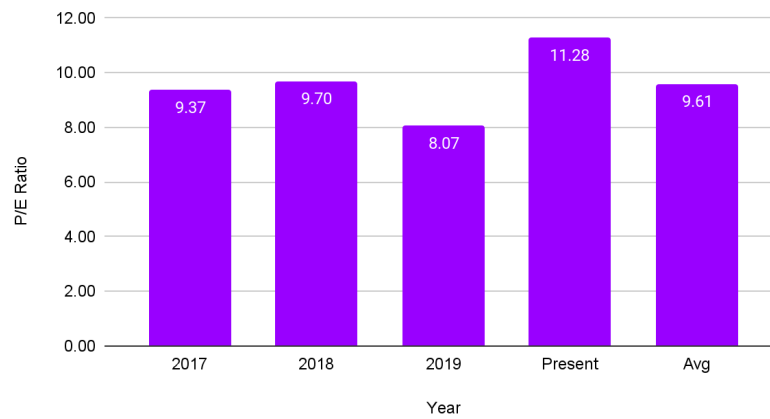


Price to Earnings Ratio of Regional vs Banorte vs Banco del Bajío

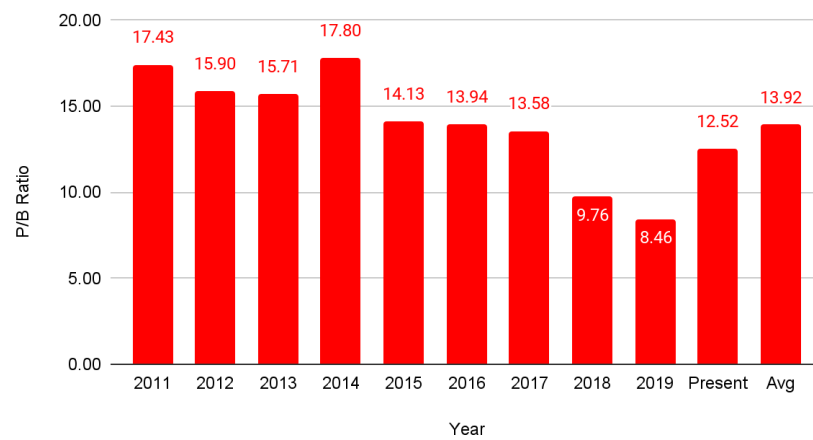
Regional's P/E Ratio



Banco del Bajío's P/E Ratio

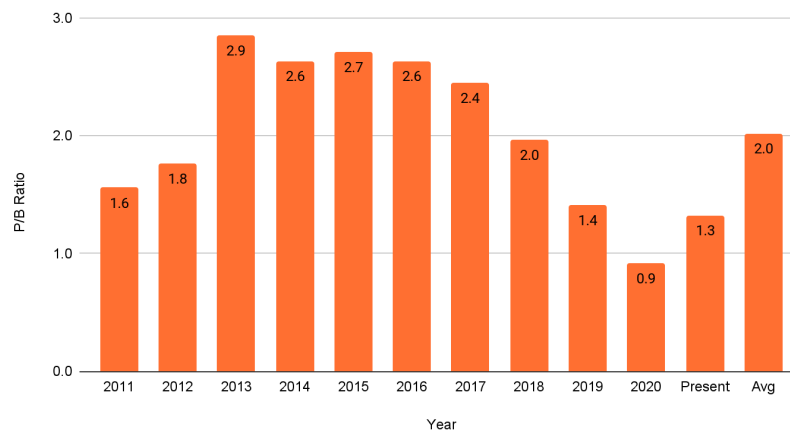


Banorte's P/E Ratio

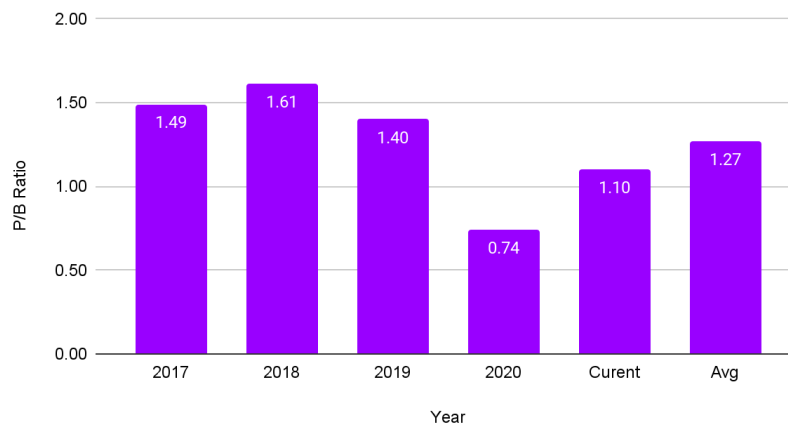


Price to Book Ratio of Regional vs Banorte vs Banco del Bajío

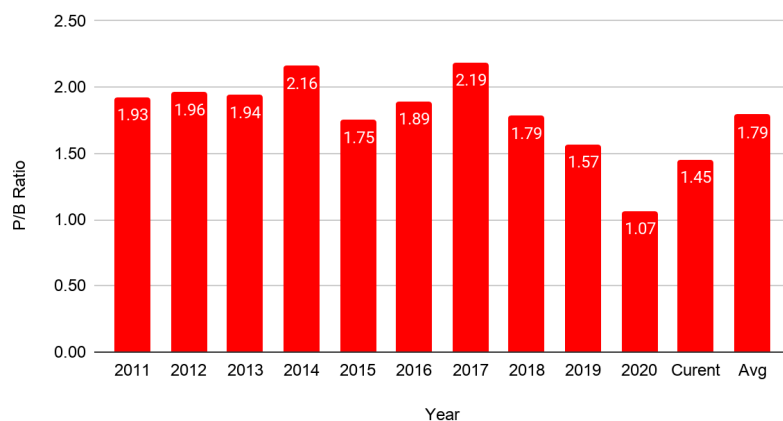
Regional's P/B Ratio



Banco del Bajío's P/B Ratio



Banorte's P/B Ratio



Conclusion

Although the Mexican banking industry is highly competitive, I think Regional has been able to achieve superior results thanks to its cost structure and focus on SMEs. As mentioned before, with only 156 branches, that represent 1.2% of bank branches, Regional has 2.0% market share in total loans and 3.4% market share in commercial loans, nationally. This translates into lower costs and higher operating efficiency. Likewise, Regional's higher financial margin and lower non-performing loans thanks to its specialization on SMEs has allowed the bank to be highly profitable. In effect, Regional has been one of the top 5 most profitable banks in México throughout the years.

VALUATION

Why I am analyzing this company:

- Regional's earnings grew at a CAGR of 19% from 2008 to 2019,
- Regional's shareholder's equity increased at a compounded annual rate of 23.2% from 1994 to 2019, even with the payment of \$3,178 million pesos in dividends.
- The company has maintained high and constant returns.
- Regional is one of the top 5 most profitable and efficient banks in the Mexican Banking Industry.
- The company's CEO and Board President are major shareholders in the company. Owning roughly 13.63% of the company's shares outstanding.
- Regional is currently trading at a lower P/E and P/B ratio than its historic average.

Analysis Outline: How I plan to evaluate this company:

I will begin my valuation by doing an excess returns valuation to value the intrinsic value of Regional's equity. In such a model, the value of Regional's equity will be the sum of Regional's current tangible book value of equity and the present value of returns above Regional's cost of equity that the company expects to make in the future. Excess returns are added to current tangible book value to calculate the intrinsic value of a company's equity because these returns actually create value. A firm that invests its equity and earns just the fair-market rate of return on these investments should see the market value of its equity converge on the equity capital currently invested in it. Likewise, a firm that earns a below-market return on its equity investments will see its equity market value dip below the equity capital currently invested, and vice-versa.

I decided to represent Regional's total current invested capital in this model as the company's current book value of equity for two reasons. The first is that the assets of a financial service firm are often financial assets that are marked up to market. The second is that depreciation, which can be a big factor in determining book value for manufacturing firms, is often negligible at financial service firms.

Equally important, the excess returns, defined in equity terms, can be stated in terms of expected sustainable return on equity and cost of equity for the company. In effect, excess returns will equal $(\text{Return on Equity} - \text{Cost of Equity}) \times (\text{Current Book Value of Equity})$.

I will then complement my excess returns valuation by analyzing if Regional is selling at an attractive price relative to its earnings and equity book value through 2 equity ratios: Price to Earnings and Price to Book.

The valuation steps are outlined below.

- Apply an Excess Returns Valuation
 - Base Case Scenario

- Calculate Expected ROE
 - Calculate Cost of Equity
 - Calculate Present Value of Equity Excess Return – next 5 years
 - Calculate Present Value of Terminal Value of Excess Returns
 - Calculate the Value of Regional's Intrinsic Value
 - Margin of Safety
- Apply an Equity Multiples Valuation
 - Base Case P/E Ratio
 - Pessimistic P/E Ratio
 - P/B Ratio
- Conclusion

Step 1.1 : Calculate Regional's Sustainable Return on Equity

The first step in our excess return valuation is to estimate Regional's short-term future return on equity and its sustainable future return on equity. While Regional's return on equity has ranged from 13.3% to 18.6% between 2011 and 2021, the average being 16.7% including 2020, the expected return on equity in the near future will be lower. Due to the lower credit demand arising from the pandemic. Thus, for the next 2 years, we will assume that the return on equity at Regional will be 14%. Then, in 2024, we will assume that ROE will increase to a sustainable 16.7% point.

Year	Expected 2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011
ROE	14%	13.3 %	18.6 %	18.1 %	18%	17.6 %	16.2 %	17.2 %	18%	16.6 %	16.8%

Step 1.2 : Calculate Regional's Cost of Equity

To calculate the company's cost of equity I will estimate the current returns required to attract equity investors to a company with the same risk characteristics as Regional. Because debt investments are inherently less risky than equity investments. If we look at the returns required to attract debt investors to investment grade (at least BAA rated) bonds with low probabilities of default we can find the starting point on the cost of attracting higher risk equity financing. Thus, if current BAA returns are around 3.2% and returns required to attract investors to new possible venture capital funds are around 14%. The range of possible equity costs of capital for Regional lies between 5% and 14%. A bank like Regional with high return on equity, a well diversified portfolio and client base, and a low percentage of non-performing loans, but with operations in Mexico, would have an equity cost of capital of average risk. Within the 5%-14% range, the low-risk firm would have a 5%-7% cost of equity, an average risk firm would

have a 7-11% cost, a higher than average risk firm would have a cost of 11-13%, and a high risk firm would have a cost of capital of 14%. Thus, we will assume 11% as our equity cost of capital.

Step 1.3 : Calculate Present Value of Equity Excess Return – next 5 years
(in millions of MXN)

	2022	2023	2024	2025	2026
Net Income	3,355	4,457	5,061	5,798	6,584
- Equity Cost (see below)	2,636	2,935	3,333	3,819	4,336
Excess Equity Return	719	1,522	1,728	1,979	2,248
Cumulated Cost of Equity	1.110	1.232	1.367	1.518	1.685
Present Value	647	1,235	1,264	1,303	1,334
Beginning BV of Equity	23,965	26,690	30,309	34,719	39,427
Cost of Equity	11%	11%	11%	11%	11%
Equity Cost	2,636	2,935	3,333	3,819	4,336
Return on Equity	14%	16.7%	16.7%	16.7%	16.7%
Net Income	3,355	4,457	5,061	5,798	6,584
Dividend Payout Ratio	18.8%	18.8%	18.8%	18.8%	18.8%
Dividends	630	838	951	1,090	1,238

paid					
Retained Earnings	2,725	3,619	4,410	4,708	5,347

In the table above, the net income each year is computed by multiplying the return on equity each year by the beginning book value of equity. The book value of equity each year is augmented by the portion of earnings that is not paid out as dividends; the dividend payout ratio is based upon current dividends and normalized earnings. Finally, the accumulated cost of Equity is the cost of equity, 11, to the power of n, n being the period in which it is calculated.

Since 2021 FY is almost over, my excess returns valuation will include years from 2022 to 2026, assuming that the beginning book value of equity in 2022 is 8% greater than at the end of 2020—\$23,956. An increase of 8% was used because that represents the difference from Q3 2020 to Q3 2021.

Present Value of Excess Returns—5 years = **\$5,783 million pesos**

Step 1.4 : Calculate Present Value of Terminal Value of Excess Returns

To maintain a conservative valuation, I will not assume earnings growth after year 5. In effect, maintaining a sustainable ROE of 16.5%, net income in year 6 will be $((\$5,347 + \$39,427) * 0.16.5) = \$7,387$ million pesos. The terminal value of excess returns to equity investors can then be computed.

$$\frac{\text{Net income} - (\text{Cost of Equity} * \text{BV of Equity})}{(\text{Cost of Equity})} \\ (7,387 - (0.11 * (\$5,347 + \$39,427))) / (0.11) = 22,380 \text{ million pesos}$$

PV of terminal value of excess returns: **\$11,965 million pesos** = $22,380 / (1.11)^6$

Step 1.5 : Calculate Present Value of Regional's Equity

The value of equity can then be computed as the sum of the three components: the current tangible book value of equity, the present value of excess equity returns over the next 5 years, and the present value of the terminal value of equity.

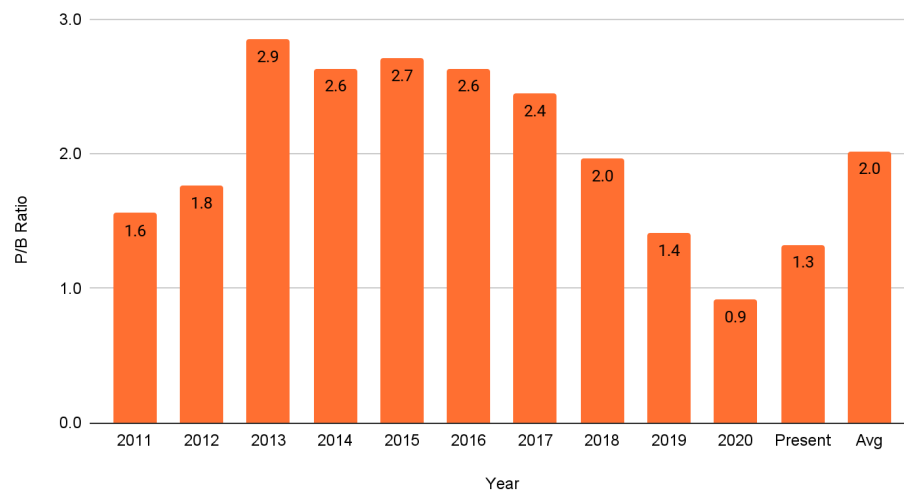
- Current Tangible Equity Book Value = \$23,965 million pesos
- PV of Equity Excess Return – next 5 years = \$5,783 million pesos
- PV of terminal value of excess returns = \$11,965 million pesos
- Value of Equity = \$41,713 million
- Number of shares = 327,931,331
- Value Per Share = \$127 pesos

At the time of this valuation on Dic 11 2021, Regional was trading at \$94.5 pesos per share.

Step 1.6 : Margin of Safety

At a valuation of \$127 pesos per share and an equity market value of \$94.5 pesos per share, Regional's equity is selling at a discount of around 25%. Given that this valuation did not incorporate future growth after year 5, I think Regional is selling at an attractive market price and can potentially be a rewarding investment. Furthermore, at this valuation, Regional is selling at a price to book ratio of 1.77, which is acceptable, given that on average the company sells at 2 times its book value. Finally, it is important to note that this valuation does not account for the potential value of Hey Banco, the company's fast growing neobank that is expected to branch off and become an independent public company in the near future.

Regional's P/B Ratio



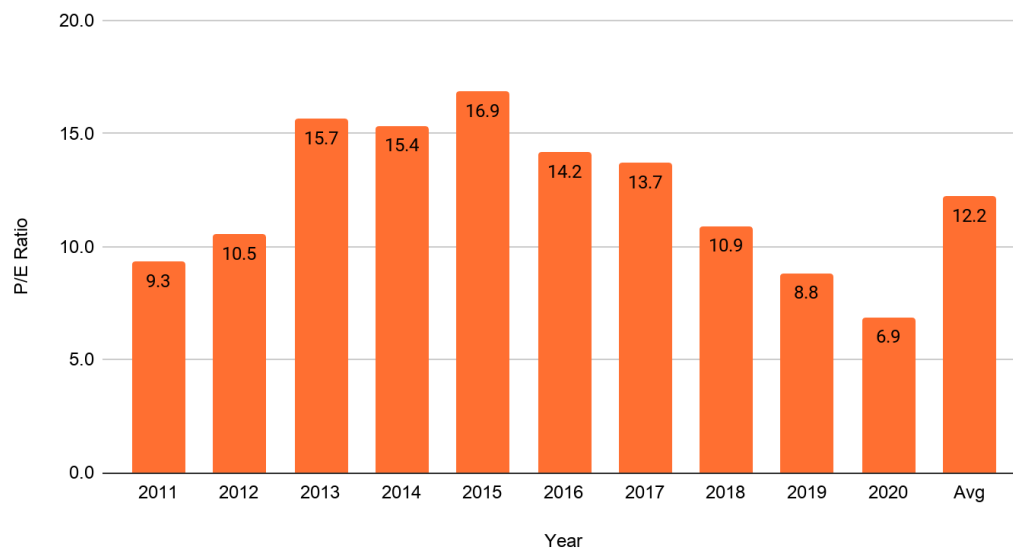
Step 3 : Multiples Valuation

Step 3.1 : Calculate Regional's P/E Ratio

I will first calculate Regional's P/E ratio by using its current equity market price of \$31,100 million, equity book value of \$23,508 million, and a sustainable ROE of 16.7%. With these parameters, Regional's P/E ratio is around 8 ($31,100 / (23,508 * 0.167) = 8$). Given that Regional's historical average P/E ratio has been 12.8, I think Regional is currently selling at an attractive multiple. Additionally, although the net income of \$3,925 is acceptable because it is roughly 8% higher than the net income achieved in 2019 and the equity book value of the company has grown 19.4% since then.

However, to remain conservative and complement my base case multiples valuation, I will also calculate Regional's P/E ratio with a ROE of 14%—the current ROE. With this ROE, Regional's expected earnings comes to around \$3,291 million and produce a P/E ratio of 11 ($31,100 / (23,508 * 0.14) = 9.44$). Given that Regional's historical average P/E ratio has been 12.8, my conservative calculated price to earnings multiple of 9.44 is still below the historic average.

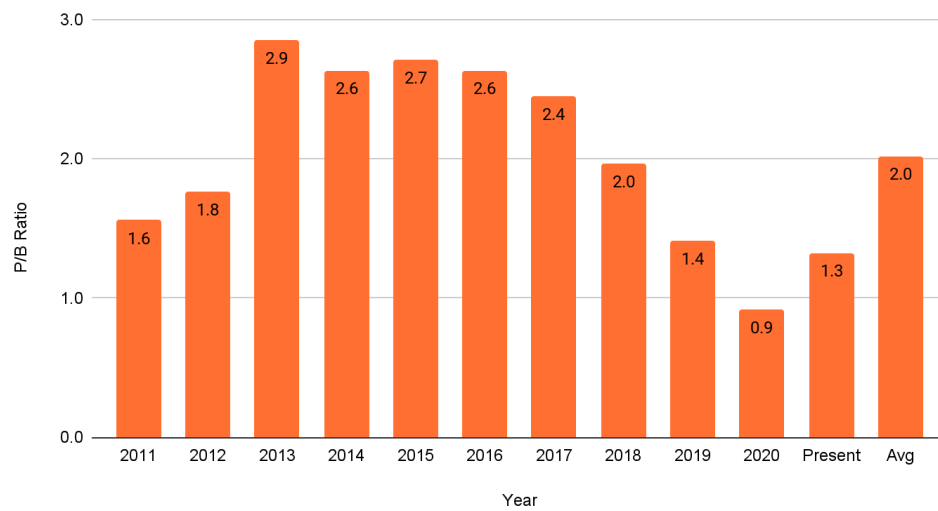
Regional's P/E Ratio



Step 3.2 : Calculate Regional's P/B Ratio

To calculate Regional's P/B ratio, my parameters will be its current equity market price of \$31,100 million, and its current equity book value of \$23,508 million. With these values, Regional's current P/B ratio is 1.3. Given that the company's historical average P/B ratio is 2.0 and that the company's earnings grew at a compounded annual growth rate of 19% from 2008 to 2019, I think Regional's current P/B multiple also indicates that the company is undervalued.

Regional's P/B Ratio



Step 4 : Conclusion

Both my excess returns and equity multiples valuations indicate that Regional's equity is selling at a discount relative to its current equity market price. This is true even with the exclusion of growth after year 5 in my excess returns valuation and not including the potential value of Hey Banco. Thus, I believe an investment in Regional could be very rewarding because of its low risk and potential upside, thanks to the price at which it is selling. In effect, my recommendation is to **invest**.