

▲ Target Price

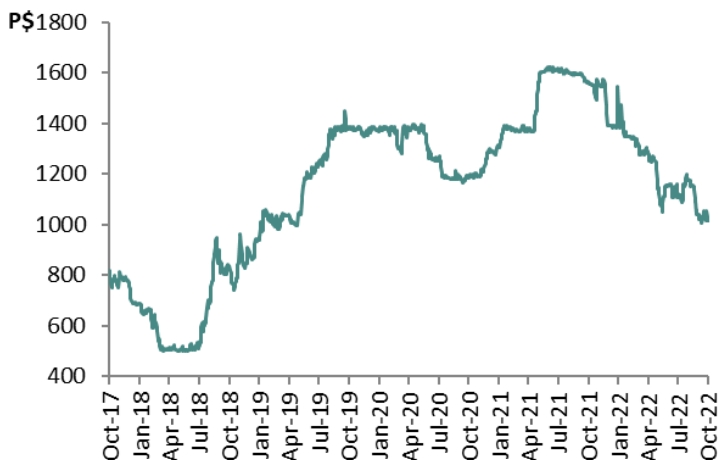
▲ Rating

▲ Estimates

Grupo Elektra, S.A.B. de C.V

Explanation of the structure of the Senior Notes issued by the group's Nueva Elektra Del Milenio, S.A. de C.V. subsidiary

ELEKTRA *



BUY			
Target Price 2023-IV:		P\$1,672.00	
Close Price (10/04/2022):		P\$ 1,016.75	
Estimated Dividend 2023 (P\$ per share)		P\$ 5.40	
Total appreciation (with dividends)		65.0%	
Market Capitalization (million P\$):		249,698	
Max Quarter	P\$ 1,289.10	P/E	nd
Min Quarter	P\$ 1,047.52	EV/EBITDA	12.6x
% Chg Quarter	-9.88%	Net Debt/EBITDA	1.37x
P\$ million	2022-II LTM	2021-II LTM	Δ% yoy
Revenues	154,915	130,761	18.5%
EBITDA	22,250	16,853	32.0%

Overview

This report describes the structure of the Senior Notes listed on the Luxembourg Stock Exchange in January 2021 by Nueva Elektra del Milenio, S.A. de C.V., a subsidiary of Grupo Elektra, S.A.B. de C.V, through a Special Purpose Vehicle (SPV). The notes amounted to US\$500 mn with a seven-year term and an interest rate of 4.875% and were the subject of a private offering of securities abroad.

The purpose of the report is to explain the cash flow stream guaranteeing the payment of interest and principal on the Senior Notes, which are currently Grupo Elektra or Nueva Elektra del Milenio's only international structured issuance.

The issuance has a Reserve Account funded on day 1 with the proceeds derived from it, which will be used in the event of any principal or interest payment shortfall; in other words, the issuance has a liquidity guarantee. It also has a corporate guarantee, which means that in the event of default, Grupo Elektra must meet all principal and interest payments on the notes.

We also comment on Grupo Elektra's (ticker symbol: ELEKTRA*) second quarter earnings and take a closer look at the historical performance of the group's money transfer business in order to explain the cash flows guaranteeing the payment of interest and principal on the notes.

The report also includes a brief description of the historical performance of domestic remittances.

Background

Grupo Elektra was founded in the 1950s as a radio broadcast transmitter manufacturer before subsequently moving into the retail sector with the inauguration of its first store.

Grupo Elektra is the leading Latin American provider of banking services, consumer finance and specialty retailing targeting the C+, C, C- and D+ socioeconomic segments. It is also the largest source of short-term non-bank loans in the U.S. through its Purpose Financial, Inc. subsidiary serving the U.S. middle class.

Grupo Elektra currently has 6,165 points of contact. In the last 12 months, 29 new stores have been opened in Mexico in strategic locations offering a mix of merchandise and services to maximize customers' shopping experience.

As of the second quarter of 2022, the group had 4,774 points of contact in Mexico, 1,017 in the U.S. and 374 in Central America. A large distribution network gives Grupo Elektra proximity to its customers which facilitates enhanced customer service and translates into superior positioning across markets.

The points of contact operate under the following names: Elektra, Salinas y Rocha, Banco Azteca, Purpose Financial and Financial services stores.

Q222 Financial Results

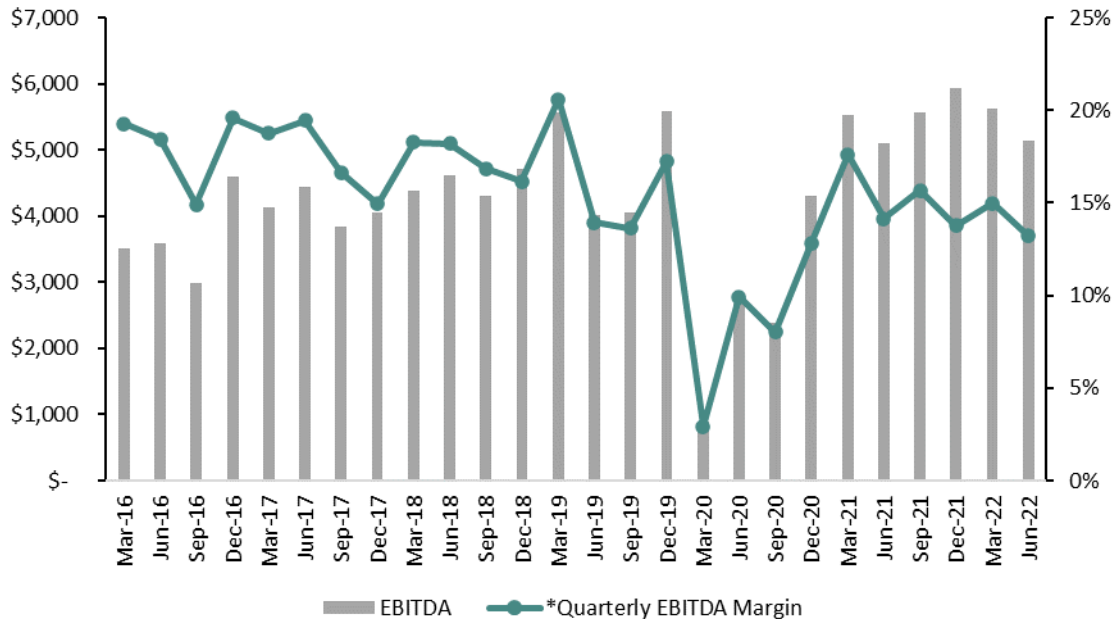
Grupo Elektra reported consolidated second quarter 2022 earnings of P\$38.817 bn, an increase of +7.6% y/y. Earnings were mainly driven by +10.8% y/y growth in interest income, which reflects solid loan portfolio growth, and higher retail division revenues, which rose +3.7% y/y. Interest income accounted for 57.1% of total revenues compared to 55.5% in the year-ago period.

Consolidated costs rose +0.3% y/y to P\$17.801 bn, mainly due to lower financial costs, which decreased -3.6% y/y as a result of less loan-loss provisions, partially offset by higher interest expense in line with the current interest rate environment. Business costs increased +2.3% y/y, in line with higher revenues from merchandise sales.

Selling, general and administrative expenses amounted to P\$15.883 bn, +20.1% y/y owing to relatively higher operating and personnel expenses arising from the development of logistics strategies to drive product supply timelines in order to meet growing merchandise demand as well as systems development to underpin the efficiency of the company's digital operations.

Q222 EBITDA totaled P\$5.133 bn, +0.9% y/y; however, the **EBITDA margin** decreased -88 bp y/y, reflecting higher **selling, general and administrative expenses**. The EBITDA margin was 13.22% for the quarter.

Figure 1. Grupo Elektra's Quarterly EBITDA Trend (P\$ mn)



Source: Signum Research, Economatca and company data
*Right axis

The **comprehensive result of financing** decreased by P\$5.282 bn compared to a P\$6.087 bn increase in the second quarter of 2021. This can be traced to a 10% decrease in the market value of the company's underlying financial instruments — which do not imply cash outflow— compared to an 18% increase in the same year-ago quarter.

Finally, the company posted a P\$1.762 bn **consolidated net loss** compared to a P\$6.948 bn **net profit** in the same year-ago quarter, mainly due to a comprehensive financing cost as well as higher operating expenses.

Retail division

Second quarter retail revenues amounted to P\$16.646 bn, +3.7% y/y, and accounted for 42.9% of total revenues. Solid sales of Italika motorcycles were the main driver, and along with the Hero brand accounted for 34% of total retail revenues.

Sales of motorcycles have proven defensive, driving growth both during the pandemic and following it, as motorcycles are an efficient means of transport both for personal and business purposes.

Large household appliances also experienced strong growth, amounting to 14% of retail revenues. A large supply of products at competitive prices and under favorable credit conditions have translated into a very favorable value proposal for the group's customers.

Total remittances in Mexico have reached record highs, favoring Elektra's money transfer business.

Breakdown of the retail division's revenues:

- Italika (34% of retail revenues): this is Elektra’s own brand of motorcycles with a 61% share of the Mexican motorcycle market. The brand is present in Mexico, Guatemala and Honduras. There are currently six production lines and approximately 780,000 motorcycles have been assembled in the last 12 months and sold through more than 4,700 points of sale, including: Elektra.com.mx, Tienda.Italika.mx and its mobile application Italika+. Around 6.9 mn motorcycles have been sold since 2005, and in 2021 the company launched the Hero brand in Mexico.

- Telephony (20%)
- Large household appliances (14%)
- Electronics, furniture, computers and others (24%)
- Non-merchandise services (8%)

Financial division

As of January 1st, 2022, Banco Azteca México began using IFRS-9 (‘Financial Instruments’) and IFRS-16 (‘Leases’) which are part of the International Financial Reporting Standards (IFRS), to report its financial statements. Those changes translated into growth in the loan portfolio, in loan-loss provisions and in taxable income (IFRS-9) as well as growth in right-of-use and lease ability assets (NIIF-16) compared to the same 2021 numbers.

The consolidated gross loan portfolio of Banco Azteca México, *Purpose Financial* and Banco Azteca Latinoamérica grew +17.8% y/y, totaling P\$149.219 bn as of June 30th, 2022.

Banco Azteca México’s gross loan portfolio rose +31.6% y/y, reaching P\$143.262 bn. As of the second quarter of 2022, the bank’s non-performing loan ratio was 3.6%, -20 bp y/y.

Grupo Elektra’s consolidated deposits grew +12.3% y/y and amounted to P\$202.884 bn. Banco Azteca México’s traditional deposits amounted to P\$199.360 bn, up from P\$177.723 bn in the year-ago quarter.

Banco Azteca México maintained high solvency levels in the second quarter of 2022, reporting a 15.49% capitalization ratio, which is above the required regulatory minimum.

Below we include a breakdown of the financial division’s revenues:

- Banco Azteca (84% of revenues): Mexico’s largest bank in terms of the number of branches and personal loans with a presence in 200 of the country’s municipalities with no other banking services. It operates in Mexico, Guatemala, Honduras and Panama. It is a digital bank with a growing deposit base and a flexible cost of funding that charges no commissions.
- Purpose Financial (11%): a reliable source of short-term non-bank loans for middle-class U.S. workers and is a leader in “pay-day loans.”
- Seguros Azteca (4%): life and non-life insurance as well as micro health and accident insurance.
- Afore Azteca (1%): retirement fund management services.

- Punto Casa de Bolsa (<1%): brokerage services that use competitive tools to encourage investment by simplifying financial market concepts.

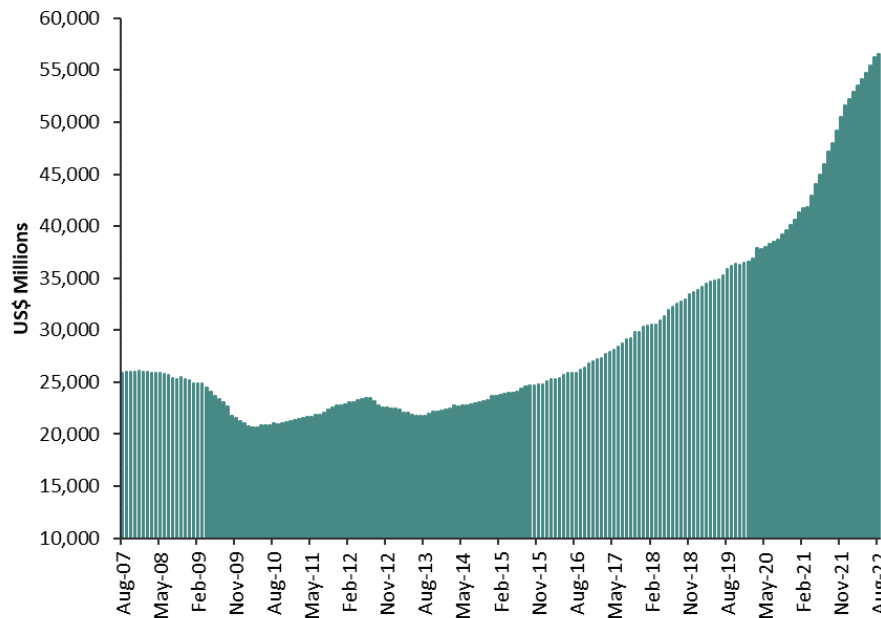
Money transfers

Remittances grew +7.8% y/y in August, ending the month at US\$5.122 bn, for a monthly decrease of -3.31% after five consecutive monthly increases. **Last-12-month remittances amounted to US\$56.579 bn**, +20.0% y/y, and the highest amount for any such period since 1995. Indeed, remittances have been growing reading upon reading, reaching historical highs.

The number of **transactions** totaled **13,124,302**, +6.9% y/y, and the average transaction amount was US\$390, +0.78% y/y.

Assuming an end-of-month fix exchange rate, remittances grew +8.0% y/y in August totaling P\$102,923 bn. The y/y increase which resulted from their conversion into pesos, was the result, mainly, of the growth in the number of transactions and, to a lesser extent, due to the dynamics in the exchange rate, as the peso depreciated marginally 0.18% y/y. It should be mentioned that in seasonally-adjusted terms and at constant prices, **remittances account for slightly less than 5% of GDP**.

Figure 2. Historical Remittances (US\$ mn, LTM figures)



Source: Banxico

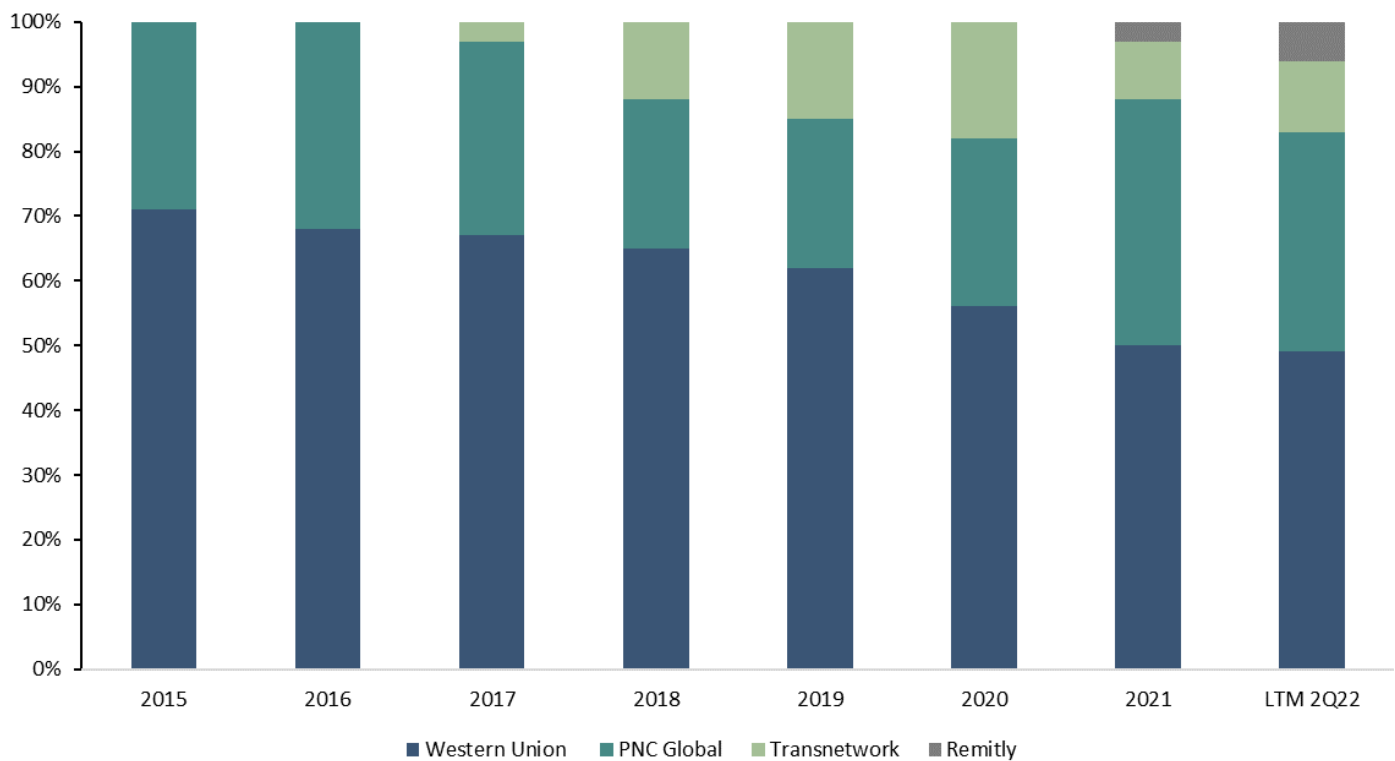
Nueva Elektra del Milenio, a subsidiary of Grupo Elektra, is the largest money transfer paying agent in Mexico. Nueva Elektra del Milenio is also the most recognized brand in the target market, displaying sustained growth rates in both clients and the number of transactions.

Nueva Elektra del Milenio has two types of money transfer or remittance methods depending on the transmitter, remitter or Money Transfer Operators (MTOs) – companies resident abroad that receive the remittance amounts and deliver them to the beneficiaries. **The difference between the two methods lies mainly in the type of funding involved:**

- **Prefunding:** the remitter funds the transactions upfront based on an estimate of daily operations. In other words, the remitter sends the money to Nueva Elektra del Milenio in advance as payment.
- **Reimbursements:** Nueva Elektra del Milenio uses its own resources to pay remittance beneficiaries at the instructions of the remitter, and the latter reimburses Nueva Elektra del Milenio for the same amount the next business day.

According to information provided by the company, **around 40% of its daily remittance transactions use the prefunding method and 60% the reimbursement method.**

Figure 3. MTOs' Percentage Share of Total Reimbursements included in the transaction structure



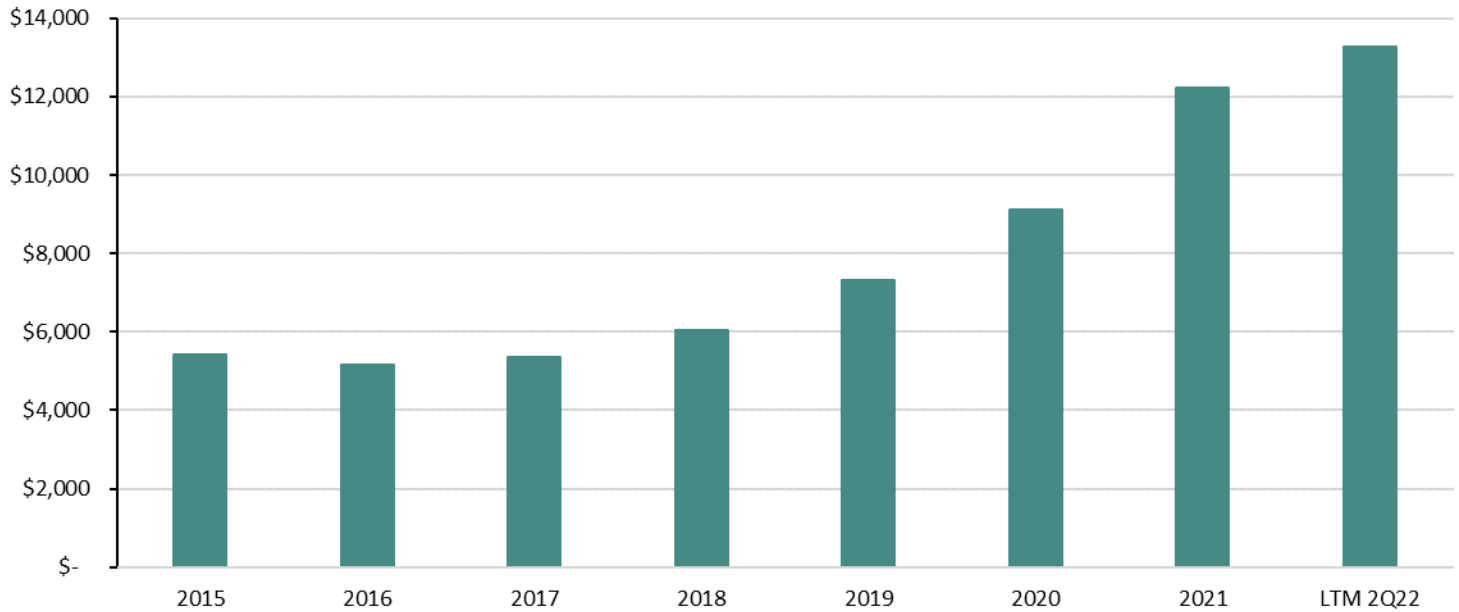
Source: Grupo Elektra

The main money remitters or MTOs that Grupo Elektra works with under the reimbursements method are:

- Western Union: the alliance began in 1993 and was renewed in 2006, 2012 and 2019
- PNC Global: began in 2012
- TransNetwork: began in 2017
- Remitly: began in 2021

As of June, 2022, LTM reimbursements flows amounted to US\$13.262 bn.

Figure 4. Reimbursement Remittance Flows from main MTOs (US\$ mn, LTM figures)



Source: Grupo Elektra

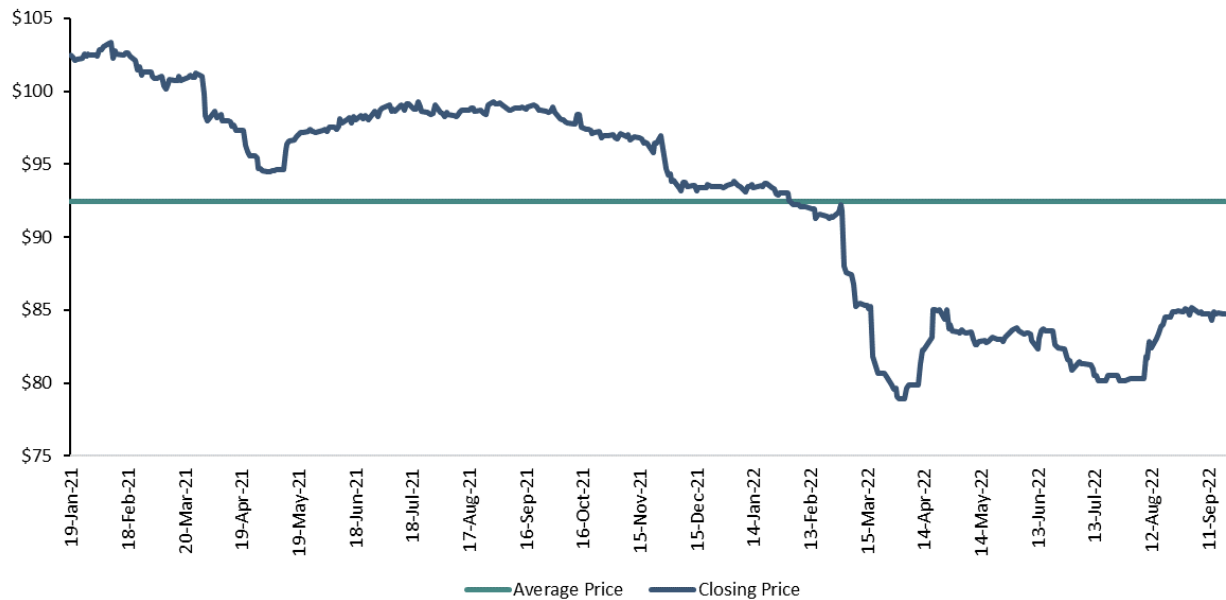
Transaction structure

As previously mentioned, in January, 2021, Nueva Elektra del Milenio, a Grupo Elektra subsidiary, issued US\$500 mn of Senior Notes in the Luxembourg Stock Exchange. The issuance has an operating and liquidity guarantee consisting of MTO or remitter cash flows provided by Nueva Elektra del Milenio on a daily basis to meet principal and interest payments on the notes, if required.

Below we explain the transaction’s cash flow stream to give public inventors certainty about the guarantee.

Assuming that on day t , Nueva Elektra del Milenio delivers US\$100 in remittances to its customers, 60% of which took place using the reimbursements method, or US\$60 of the US\$100. That means that Nueva Elektra del Milenio used US\$60 of its own resources to cover that day’s operations, while the other US\$40 were previously funded by the MTOs operating under the prefunding scheme.

Figure 5. Price of the Senior Notes since Issuance vs. their Average Price



Source: Bloomberg. Data gathered at the end of 09/26/2022

The next day, or on $t+1$, remitters using the reimbursements method must transfer the resources that Nueva Elektra del Milenio used to a **Pass-Through Account** in Mexican pesos opened with Citibanamex under Citibank N.A. –the guarantee agent. Cash flows that remittance companies deposit in the **Pass-Through Account do not constitute income for Nueva Elektra del Milenio**, as income from remittances or money transfers is based on fees, not on principal.

Pass-Through Account cash flows are subsequently transferred to a **Collection Account** in Mexican pesos located in London under SPV (Special Purpose Vehicle).

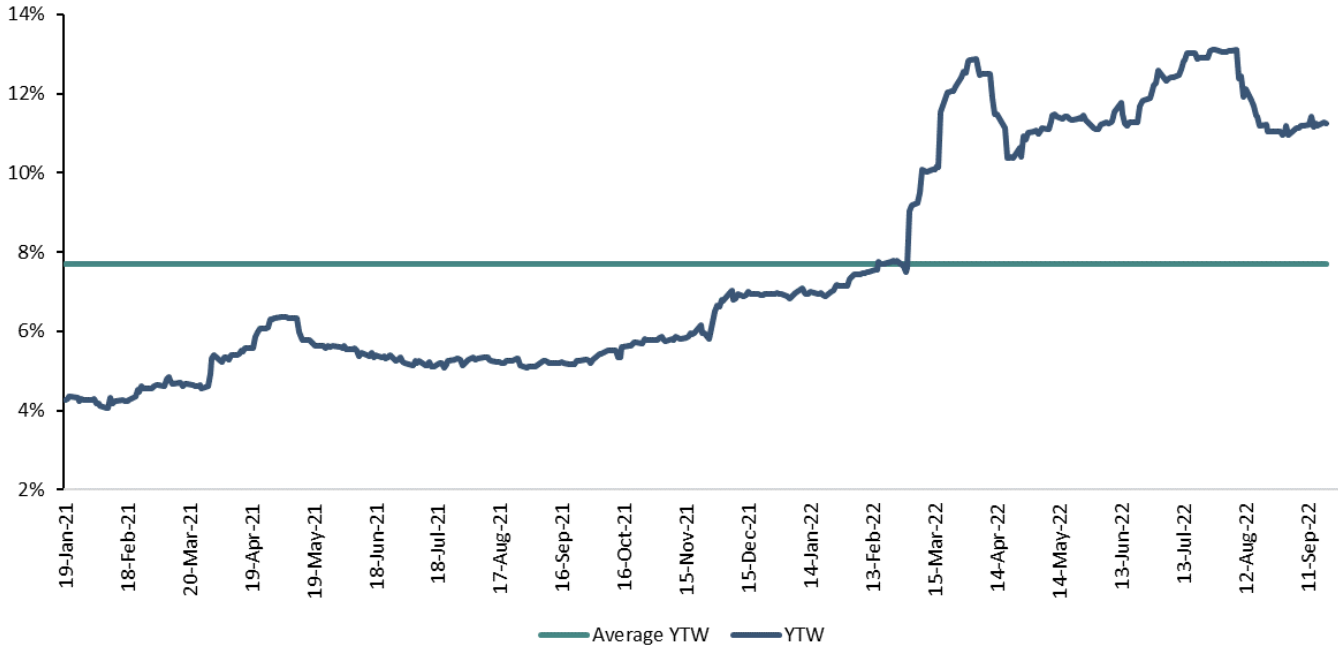
Next, Collection Account cash flows are transferred to two separate accounts: the **Programmed Payments Account** and the Series “N” Account, both of which are denominated in US dollars and located in New York under SPV. Any surplus cash flows are returned to Nueva Elektra del Milenio.

Series “N” Account cash flows are used to make interest and capital payments to investors or holders of Nueva Elektra del Milenio senior notes.

As its name implies, the **Programmed Payments Account**, is used to meet placement expenses and administrative costs related to the Senior Notes issuance.

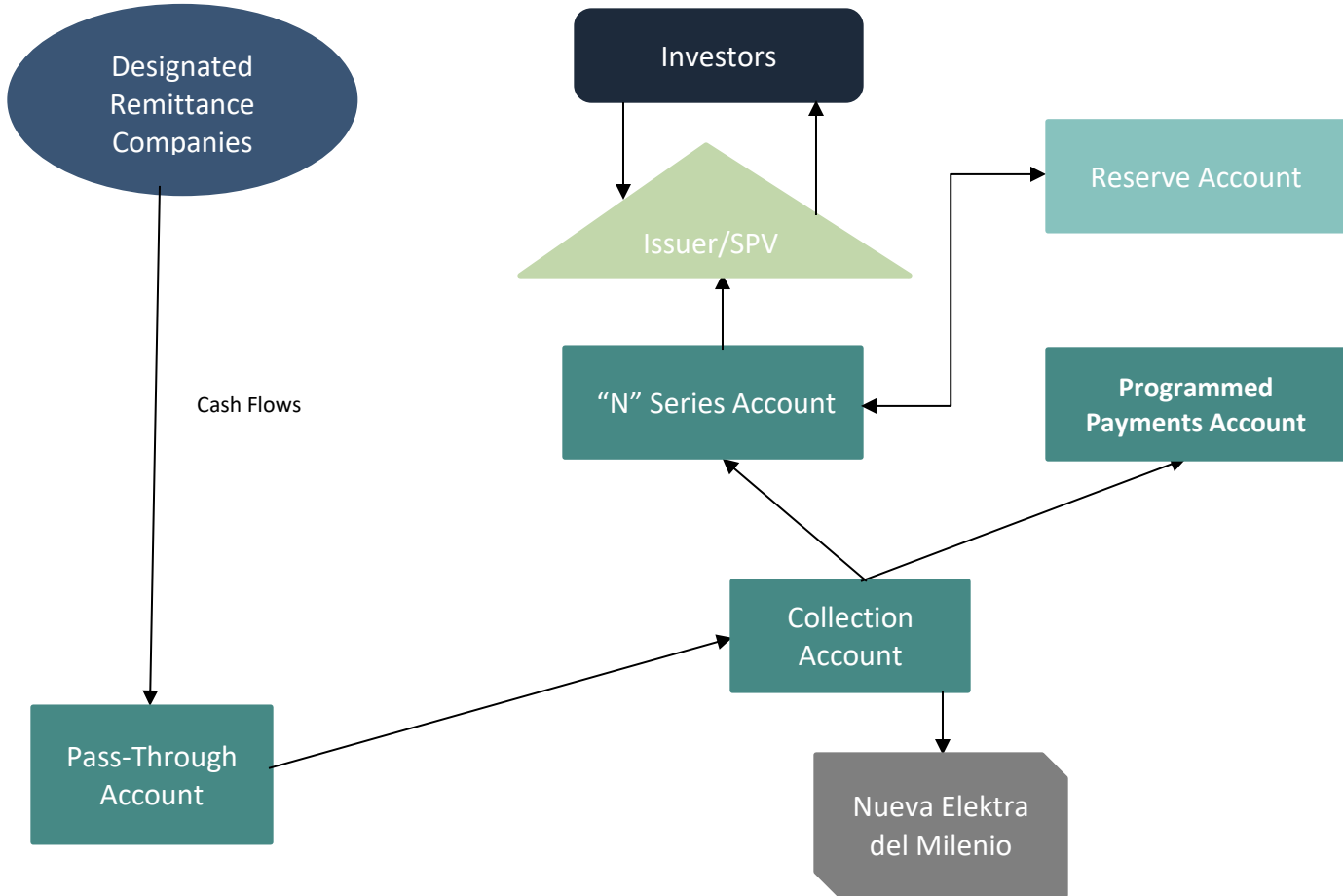
Finally, in the event of the Reserve Account not maintaining a minimum balance equal to one quarterly principal and interest payment, it will be funded with additional flows. As mentioned above, this account was funded on day 1 with the proceeds from the issuance to meet principal or interest payments in the event of any deficit. The Reserve Account is located in New York City and is denominated in U.S. dollars.

Figure 6. Yield to Worst (YTW) of the Senior Notes since Issuance vs. their Average



Source: Bloomberg. Data gathered at the end of 09/26/2022

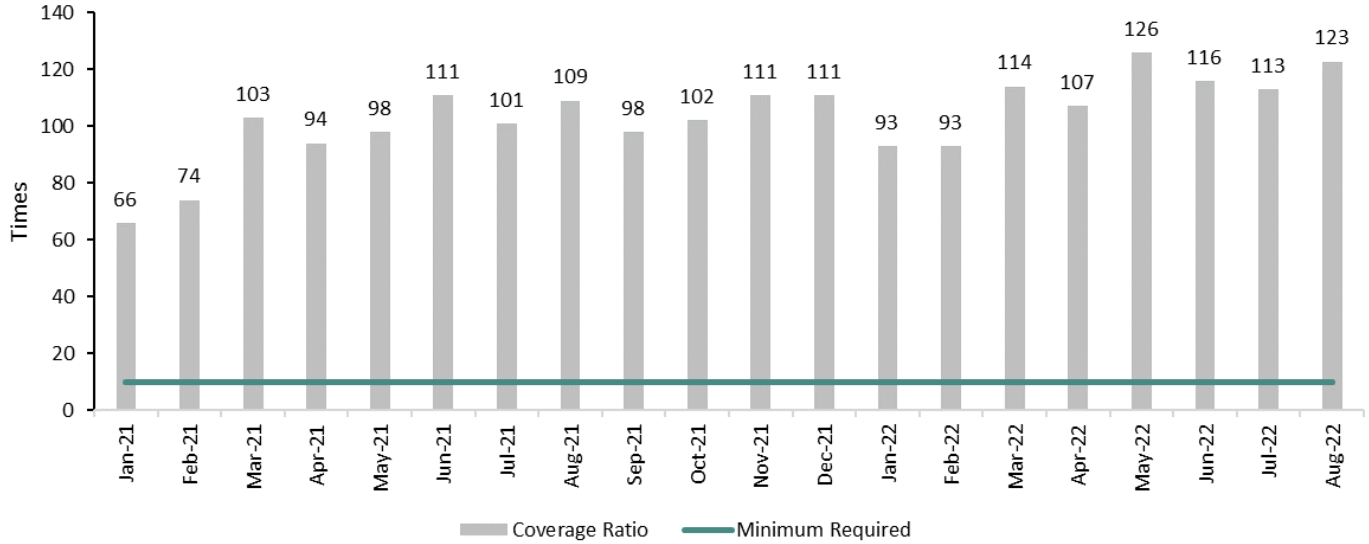
Figure 7. Transaction structure



Source: Signum Research and Grupo Elektra

According to information provided by Grupo Elektra, as of the end of August, 2022, **cash flows from reimbursement remittance transactions covered the monthly debt service 123x**; in other words, in August 2022, more than one-hundredth of the flows from the remittance transactions were used to pay interest on the Senior Notes. The **monthly coverage ratio was 103x on average**, providing **certainty with respect to Grupo Elektra’s compliance with the Senior Notes as well as the quality of the liquidity guarantee**.

Figure 8. Monthly Debt Service Coverage Ratio of the Senior Notes



Source: Signum Research and Grupo Elektra

Final remarks

Given the considerable amount of cash the issuer obtains from its money transfer operations, flows are sufficient to fully meet its credit obligations, and this is ratified by the coverage ratio.

Furthermore, due to the constitution of the Reserve Account and the operational guarantee, the issuance has a very low credit risk, in our view (credit ratings: "BB+" Fitch Ratings and "BBB+" HR Ratings).

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