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Mega expected to land inside AlphaCredit, Credivalores 9% yields – Deal Preview

05 February 2020 | 11:38 EST

PROPRIETARY
Latin America

Financial Services
Mexico

Issuer

Operadora De Servicios Mega, S.A. De C.V., SOFOM, E.R.

Book-Runner(S)

Barclays
Goldman Sachs & Co. LLC
Morgan Stanley

Other

LatAm Primary New Issuance

Operadora de Servicios Mega (BB/Ba2) could have the recent 9% yields of AlphaCredit (B-/B1) and Credivalores (B/B+) as a ceiling for its debut bond attempt, according to a buyside and a sell-side credit analyst.

Mega, a financial service firm focused on leasing, and with operations also in SMEs lending in Mexico and auto loans in the US, is on the road until today, seeking to sell USD 300m in 2025 notes. Barclays, Goldman Sachs, and Morgan Stanley are managing.

AlphaCredit, another Mexican specialty finance company, sold USD 400m in 9% 2025 unsecured bonds at par on 30 January, while Colombia-based Credivalores priced a USD 300m 8.875% bond due 2025 at 99.505, to yield 9%, on 3 February.

AlphaCredit's 2025s last traded today at 100.5, to yield 8.807%, and Credivalores's 2025s changed hands also today at 100.15, yielding 8.815%, according to *MarketAxess*.

Those comparables, nevertheless, would only set the upper end of Mega's benchmarks, with Mexico-based Unifin Financiera (BB/BB) representing the lower end, according to the buyside analyst, who has attended the roadshow.

Unifin's USD 450m 7% unsecured bonds due 2025 last traded 4 February at 103.8, to yield 5.765%.

"From 5.5% to 9% there is a lot of room, but, for me, it [Mega] should be at least 100bps wider than Unifin, in the mid-6%s," the buyside analyst noted.

While also believing that the deal should come inside the 9% ceiling set by its peers, for the sell-side analyst, though, it could price closer to the 8% area.

Although Unifin is Mega's best comparable in terms of the type of business, for many international investors all Latin American non-bank financial companies fall into the same bucket, according to the buyside analyst.

As such, the demand for Mega's transaction could be pressured by the recent deals carried out by AlphaCredit and Credivalores, as some investors could have already reached their desired exposure to the industry after those issuances, both analysts said.

Along with the usual first-time issuer premium, when being compared to Unifin, Mega could also be penalized because of its smaller size, the buyside analyst noted.

Meanwhile, a comparison with AlphaCredit is distorted by a new USD 125m equity financing that will bring the peer's capitalization ratio to abnormally high levels, potentially resulting in a rating upgrade, the buyside analyst added.

Mega finished 3Q19 with a capitalization ratio – measured as equity to the portfolio net of deposits – of 18.1%, according to the buyside analyst and two sources close to the deal.

The case of Mexarrend (formerly known as Docuformas), another Mexican company focused on leasing financing, is different, as the issuance of a USD 300m 2024 bond last year has generated a negative carry, prompting Fitch to place it on watch negative, the buyside analyst added.

Through a tender offer carried out in parallel with the bond issuance, Mexarrend repurchased USD 119.4m of its 2022 notes last year.

Regulated status bolsters fundraising

On the bright side for Mega, the regulated financial company status it has held since 2014 could provide support.

Mega is the only independent regulated entity within Mexico's top 10 leasing companies, according to the sources close, citing information provided during the roadshow. Unlike Unifin, Mexarrend or Engenium Capital – which failed to issue a debut bond following a roadshow in October 2018 – Mega is regulated by Mexico's National Banking and Securities Commission (CNBV in Spanish) and central bank, in the same way commercial banks and their associated leasing companies are.

"It's atypical, it [Mega] is the only one, but it gives them a seal of quality," the buyside analyst noted.

This regulation feature has opened doors for the company, allowing it in the past to bring German investors onboard, the buyside analyst added.

Founded in 2003 by Jalisco-based Romo family, Mega received in 2017 an equity injection from DEG Capital, a subsidiary of Germany-based bank KfW, the sources close said. DEG holds a 23.5% stake in Mega, according to Moody's.

The company obtained its first international unsecured credit line also in 2017, the sources added.

The company's board is currently comprised of seven members, with only two of them appointed by the Romo family, including chairman Jose Guillermo Romo, who before founding the company worked for the Mexican subsidiary of Citigroup and headed the Jalisco branch of development bank Nafinsa, the sources said.

As for the management, CEO Ignacio Gonzalez has held positions at C&A Mexico and E&G, while CFO Alonso Gomez worked for the National Federation of Credit Unions, among others, the sources added.

"I had a very good impression when I met with the management," the buyside analyst noted.

The strong corporate governance and experience in regulatory reporting is also expected to give some confidence to investors, as the company will be ready to adequately report to the market from day one, unlike the case of other Mexican peers when they made their respective debut in the international bond markets, the analyst added.

Excessive concentration in home state

A potential red flag, however, would be the large exposure to the home state of Jalisco.

The State of Jalisco accounted for 27.6% of Mega's loan portfolio as of September 2019, but the proportion increases to 45.9% when including a contract with the state's government, according to the sources.

"It's an important risk, they lack some diversification," the buyside analyst said.

Combined, Jalisco and three other Mexican states, Mexico City, and the US business represent around 77% of the company's portfolio, when including the Jalisco contract, according to the sources.

In January 2019, Mega won the public tender offer launched by Jalisco to provide MXN 2.16bn (USD 116m) in lease financing for heavy equipment and machinery through September 2024, with an average tenor of around 65 months, the sources said. The company partly funded the leases with a new MXN 1.5bn credit facility from HSBC.

Following several media reports, the Mexican Senate's Treasury and Public Credit Commission urged Jalisco's Comptroller and Superior Audit bodies to review the tender process in October 2019, with the objective of determining the potential existence of irregularities related to conflict of interest, influence peddling and competition simulation between companies, according to a public document at the Senate's website.

A representative from Mega did not immediately respond to a request for comment.

Lower NPLs than peers

Mega focuses on financing only productive assets in high-growth sectors, such as agriculture, tourism, or information technology, according to the sources.

As of September 2019, total assets reached MXN 10.14bn, with a net loan portfolio of MXN 8.42bn, the sources said. The loan portfolio had stood at MXN 4.61bn as of the end of 2018.

Mega's asset quality is exposed to potential deterioration because of a very rapid loan growth, particularly as the company intends to expand its loan portfolio by another 25% in 2020, Moody's warned when rating the issuance. However, the ample capitalization partially mitigates the risks related to the rapid growth and its sizable industry and single borrower concentrations, the ratings agency added.

The company finished 3Q19 with a non-performing loan (NPL) ratio of 1.5%, down from 2.6% at the end of 2018 and 3.2% at the end of 2017, according to the sources. Excluding the contract with the government of Jalisco, the NPL ratio stands at 1.8%, the sources said, citing comments made by management during the roadshow.

The NPL ratio compares with Unifin's 3.9% and Mexarrend's 5.3%, the sources added.

The company's coverage ratio stood at 96.8% as of September, slightly down from 99% at the end of 2018.

Meanwhile, Mega's leverage ratio – measured as total financial debt divided by total shareholders equity – grew to 4.9x as of September from 3.5x as of the end of 2018. During the roadshow, management attributed the increase mainly to the Jalisco contract, the sources noted.

Mega generated total revenue of MXN 1.22bn in the first nine months of the year, with some 716m from interest income and MXN 508m from other operating income and commercial margin, according to the sources. Total revenue amounted to MXN 817.7m in FY18.

Bond to improve debt profile

As of September, the company's funding was comprised of 53% in commercial bank loans, 26% in international funds, 13% in development bank financing, and 8% in domestic bonds, according to the sources. Around 64.5% of the debt was secured, and, by currency, around 75% was denominated in MXN and the remainder in USD.

With the planned USD 300m bond, Mega is seeking funds to prepay USD 142m in debt, including USD 100m in commercial bank loans, a USD 35m bridge loan with Barclays, and USD 7m in debt with development banks, with the remainder for loan portfolio growth, according to the sources.

"It seems a good mix to me," the buyside analyst said. "Releasing secured debt gives greater flexibility to the company, so taking the banks out is positive."

Also, the extended tenor of the bond will result in a better match of the maturities of assets and liabilities, the analyst added.

by Ero Partsakoulaki and Pablo Dominguez