



**MANAGEMENT'S DISCUSSION AND  
ANALYSIS OF OUR FINANCIAL  
CONDITION AND RESULTS OF  
OPERATIONS  
as of June 30, 2019**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Overview**

We are one of the largest financial services group in Honduras and through our subsidiaries, we provide a comprehensive range of corporate and retail banking, insurance and other financial services to over 3.1 million clients as of June 30, 2019. We were acknowledged as a financial holding company by the National Banking and Insurance Commission of the Republic of Honduras (The Commission) in 2012, and our main subsidiary, Banco Atlántida, S. A. (a Honduran Subsidiary), was founded in 1913. We believe that our businesses benefit from significant synergies because of being part of one financial group.

Our operations in Honduras include Banco Atlántida and Seguros Atlántida, one of the largest bank and insurance companies in Honduras in terms of assets. In addition, Banco Atlántida and Seguros Atlántida rank among the most profitable entities in the Honduran banking and insurance systems, according to the Commission. Banco Atlántida holds a distinguished position in the local marketplace in terms of total net assets, total net loans and total deposits, with market shares of 17.4%, 20.0% and 20.6%, respectively, as of June 30, 2019, according to the Commission. Furthermore, Seguros Atlántida is one of the largest insurance company in terms of total gross premiums written, with a market share of 17.6% and 16.5% as of June 30 of 2019 and 2018, respectively, according to the Commission. For the six months Ended June 30, 2019 and 2018, Banco Atlántida had a ROAE of 12.26% and 11.1%, compared with the Honduran banking system which had a ROAE of 11.1% and 12.5%, respectively. For the six months Ended June 30, 2019 and 2018, Seguros Atlántida had a ROAE of 31.3% and 28.4%, respectively. As of June 30, 2019, Banco Atlántida had one of the largest banking distribution networks in Honduras, with 2,700 points of service, comprised of 148 branches, 63 teller windows embedded within corporate client offices, 1,019 ATMs (including 307 proprietary ATMs and 712 third-party network ATMs) and 881 non-correspondent banking agents (third-party points of service).

### **Effects of changes in interest rates**

Changes in interest rates affect the following areas of our business, among others:

- financial margin;
- volume of loans originated;
- market value of our financial assets; and
- gains or losses from sales of loans and securities.

Increases in short-term interest rates could reduce our financial margin, which comprises most of our revenue. A significant portion of our subsidiaries' assets, including loans, that are long-term assets. In contrast, most deposits are short-term. When interest rates increase, Banco Atlántida must pay higher interest on deposits while interest earned on assets does not increase as rapidly, which causes profits to decrease. Interest rate increases could result in adverse changes in our financial margin, reducing our growth rate or even resulting in decreases as compared to prior periods.

Increases in the interest rate could result in adverse changes in our financial margin, reducing our growth rate or even resulting in decreases compared to previous periods.

Increases in interest rates can reduce the volume of loans originated by Banco Atlántida. The historically sustained high interest rates have discouraged our clients from borrowing and has resulted in greater asset impairment.

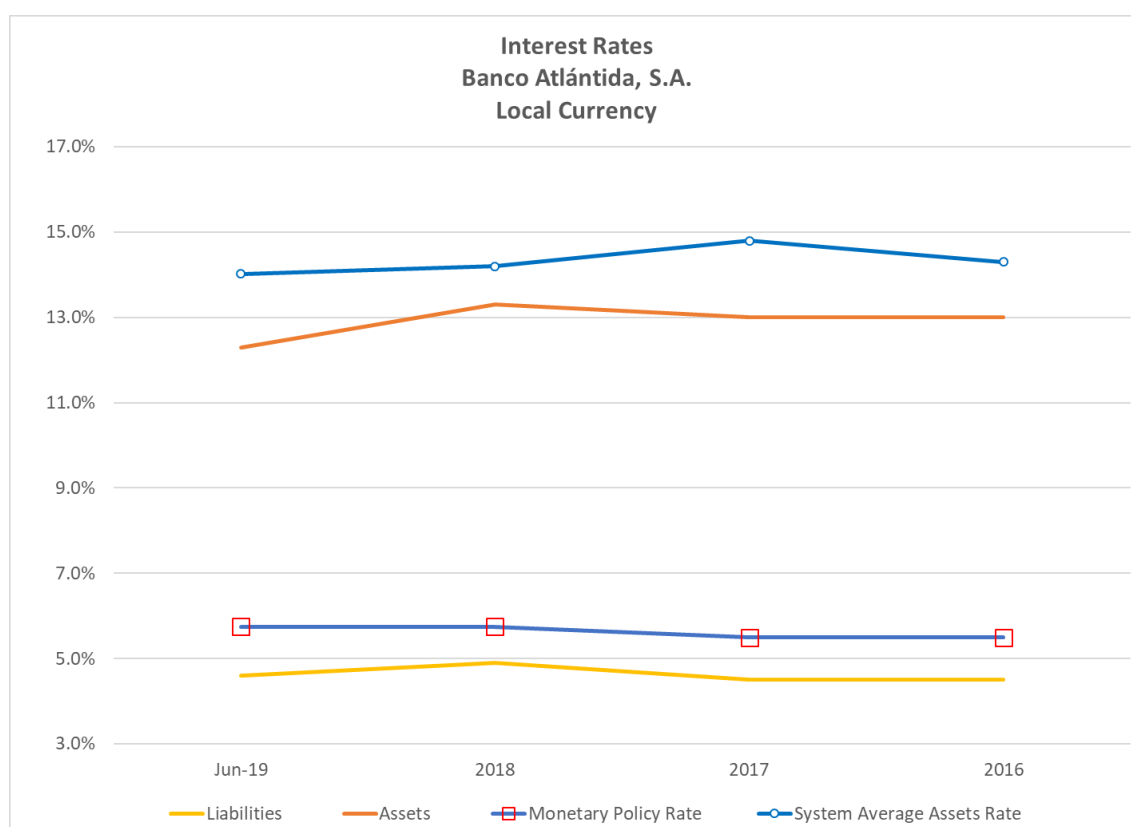
Banco Atlántida holds a substantial portfolio of loans and debt securities that has both fixed and variable interest rates. The market value of a security with a fixed interest rate generally decreases when prevailing interest rates increase, which may have an adverse effect on our earnings and financial condition. In addition, we may incur costs (which, in turn, could impact our results) as our subsidiaries implement strategies to reduce future interest rate exposure. The market value of an obligation with a variable interest

rate can be adversely affected when interest rates increase, due to a lag in the implementation of repricing terms.

Assets and liabilities have been classified by the domicile of Banco Atlántida as Domestic (operations in Honduras) or Foreign (operations outside Honduras) and by currency denomination (lempiras or US. dollars). Domestic operations include lempira- (local currency of our operations in Honduras) and US. dollar-denominated assets and liabilities. Foreign operations include US. dollar-denominated assets and liabilities. US Dollars have been converted to lempiras using the exchange rate published by the Central Bank of Honduras (Central Bank) at the relevant dates. For more information, see “Exchange Rates.” For purposes of this section, US Dollars-denominated assets and liabilities include: (I) US Dollar domestic, which includes all transactions conducted in Honduras or on behalf of Honduran residents in US Dollar and (ii) US Dollar Foreign, which includes all transactions performed with entities outside Honduras, such as multilateral and correspondent banks.

### Lempira-denominated assets and liabilities in Honduras

The chart below presents the weighted average interest rates on lempira-denominated assets and liabilities of Banco Atlántida as of June 30, 2019, 2018, 2017 and 2016.



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 modified on January 07, 2019, an increase of 0.25 pp, reaching 5.75% from 5.50% as of December 31, 2018, 2017 and 2016.

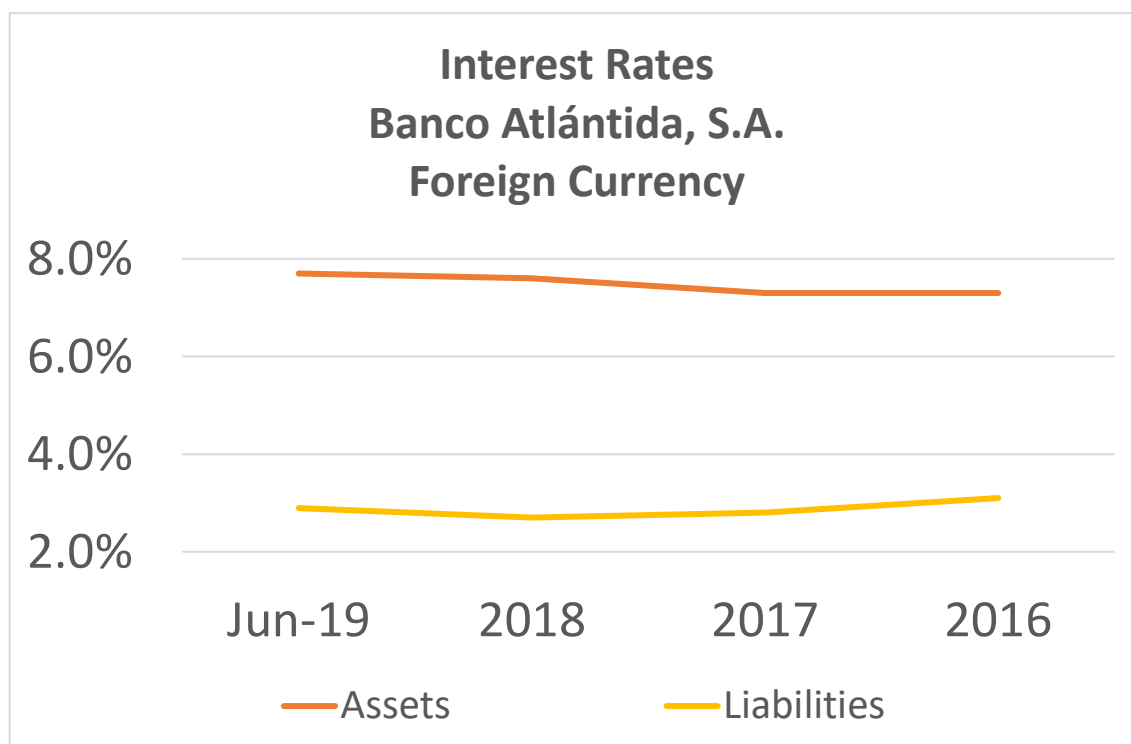
Banco Atlántida’s average interest rate on lempira-denominated assets was 12.73% as of June 30, 2019, 13.23 as of June 2018 and 12.98% as of December 2018. Banco Atlántida continues to pursue higher margin products emphasizing on personal loan products, payroll loans and credit cards. At its current interest level, as of June 30, 2019, Banco Atlántida’s lempira-denominated assets have grown 7.9% outpacing the 3.5% increase reported by the local banking system during the same period.

Banco Atlántida’s average interest rate on lempiras-denominated liabilities has increased, to a rate of 4.9% as of June 30, 2019, 4.5% as of December 31, 2018, due to liquidity constrain. As of June 30, 2019,

compared to December 2018, deposits denominated in local currency of Banco Atlántida have grown by 13.9%, while the local financial system has grown by 5.3% during the same period.

#### Foreign currency-denominated assets and liabilities in Honduras

The chart below presents the weighted average rates on foreign currency-denominated assets and liabilities of Banco Atlántida as of June 30, 2019, 2018, 2017 and 2016.



As of June 30, 2019, Banco Atlántida's average interest rate on foreign currency-denominated assets remaining stable at an average rate of 7.7% as of June 30, 2019, December 31, 2018 and 2017. Higher capital requirements for loans granted in foreign currency, particularly to non-exporting entities, continues to influence pricing of such transactions. Banco Atlántida's loan portfolio in US Dollars increased 3.5% between June 30, 2019 and December 31, 2018, while the local financial system did so in 5.2% during the same period.

The average interest rate of Banco Atlántida on foreign-denominated liabilities is 2.9% as of June 30, 2019 and 2.7% as of December 31, 2018. Banco Atlántida and the local financial system grew on foreign-denominated liabilities at a rate of 3.5% and 5.2% between June 30, 2019 and December 31, 2018 respectively.

#### Effect of family remittances

Total family remittances to Honduras from abroad were US \$ 2,565.2 million for the period ending June 27, 2019 (an increase of 10.3% over the corresponding period in 2018), US \$ 2,326.4 million for the period that ended June 27, 2018 (an increase of 8.7% of the corresponding period in 2017), US \$ 2,140.7 million for the period ended June 27, 2017 (an increase of 12.6% over the corresponding period in 2016) according to the Central Bank.

The revenue we earned from family remittances consisted of commissions for currency transactions, fees for money orders and other related fees, as well as earnings for currency exchange transactions. Through Banco Atlántida, we process US \$ 650.1 million in family remittances to Honduras from abroad for the

period ended June 30, 2019 (25.3% of the market) compared to US \$ 493.0 million in family remittances to Honduras from abroad, for the period ended June 30, 2018 (21.0% of the market).

## **Competition**

We face intense competition in all our segments, which can materially affect our growth, market share, margins and profitability. For more information, see “Honduras Financial Services Industry.”

## **Inflation**

A rise in inflation rates may impact our performance mainly because all our assets are not adjusted for the effects of inflation. In addition, material increases in the rate of inflation could result in lower demand for, and affect the pricing of, our services and products. Because much of our costs and expenses are fixed, we may not be able to reduce costs in the event of inflation. Increases in the rate of inflation could also negatively impact our loan portfolio.

The Honduran economy has been characterized by moderate inflation in recent years. As of June 30, 2019, the inflation rate was 4.8% compared to 4.2% as of June 30, 2018, due to the increase in the tariff paid for residential electricity, home leases and in the price of certain foods. At the end of 2018, the inflation rate was 4.2%, compared to 4.7% and 3.3% at the end of 2017 and 2016 respectively. The primary drivers of inflation were food and non-alcoholic beverages, utilities, gas and other fuels, clothing, housing, personal care, transportation, recreation, hotels, furniture, cafés and restaurants. According to the Central Bank, the inflation targets for 2018 was reached because it was kept within the 4.0% ( $\pm 1$  pp) range that was agreed with the International Monetary Fund (IMF).

## **Exchange Rates**

We are exposed to currency risk any time we hold an open position in a currency other than Lempira. Volatility in Lempira exchange rates in Honduras could result in higher risks associated with such positions.

In addition, any devaluation or depreciation of the Lempira against the US. dollar could have a negative impact on the ability of our subsidiaries’ clients to repay loans and make insurance premium payments, which in turn could have an adverse effect on our financial condition and results of operations.

In recent years, through a crawling peg regime, the exchange rate of the lempira against the U.S. dollar has depreciated at a stable rate. The lempira exchange rate is characterized by cyclical fluctuations in line with the export seasons of Honduras’s main agricultural commodities and the high demand for foreign currency to pay for imported goods. The exchange rate was L24.5067 per U.S.\$1.00 on June 30, 2019, compared to L23.98498 per U.S.\$1.00 on June 30, 2018, as published by the Central Bank.

## **Demographic trends**

As of 2018, Honduras had a population of approximately 9.0 million people, according to the Central Bank, which represented an estimated increase of approximately 1.6% compared to 2017. The average annual population growth rate from 2012-2018 was 7.5%. According to the World Bank, although the poverty rate in Honduras decreased to 61.9% in 2018, from approximately 66.5% in 2012, the unemployment rate increased from 4.0% in 2012 to 4.4% in 2018. GDP per capita in US dollars increased from US. \$ 2,208 in 2012 to US. \$ 2,662 in 2018, reflecting an increase in purchasing power.

As of December 31, 2017, Honduras had a population of approximately 8.9 million people, according to the Central Bank, which represented an estimated increase of approximately 2.3% compared to 2016. The average annual population growth rate from 2012-2017 was 5.7%. According to the World Bank, although the poverty rate in Honduras decreased to 64.3% in 2017, from approximately 66.5% in 2012, the unemployment rate increased from 4.0% in 2012 to 4.5% in 2017. GDP per capita in US. dollars increased from US. \$ 2,208 in 2012 to US. \$ 2,608 in 2017, reflecting an increase in purchasing power. As of December 31, 2016, Honduras had a population of approximately 8.7 million people, according to the Central Bank, which represented an estimated increase of approximately 1.7% compared to 2015. The average annual population growth rate from 2012-2016 was 4.0%. According to the World Bank, although the poverty rate in Honduras decreased to 60.9% in 2016, from approximately 66.5% in 2012, the

unemployment rate increased from 3.8% in 2012 to 4.7% in 2016. GDP per capita in US dollars increased from US\$ 2,208 in 2012 to US\$ 2,488 in 2016, which reflects an increase in purchasing power.

### **Bank loans**

The growth rate of the loan portfolio of Banco Atlántida, specifically for its retail banking segment, can be attributed to low bank penetration. In terms of bank penetration, the proportion of loans (as published by the Commission) to GDP (as published by the Central Bank) was 58.0%, as of December 31, 2018.

According to the Central Bank, as of June 30, 2019, the growth rate of bank loans to the private sector was 11.5%, compared to the growth rate of 10.3% as of June 30, 2018. For the year ended December 31, 2018, the growth rate of bank loans to the private sector was 13.4%, compared to the growth rate of 8.5% as of December 31, 2017. The main change is explained by the concession to industrial companies, commercial and service industries, as well as credit to families. Bank loans from the private sector continue to experience higher growth rates than those of the country's GDP, experiencing a recovery as of December 30, 2018 compared to December 30, 2017 as indicated above.

## Results of Operations for the Month Ended June 30, 2019 Compared to the month Ended June 30, 2018

The following table shows the principal components of our consolidated income statement for the years ended June 30, 2019 and 2018

|                                                     | June             |                  | Change          |                |
|-----------------------------------------------------|------------------|------------------|-----------------|----------------|
|                                                     | 2019             | 2018             | (HNL000's)      | %              |
|                                                     | (HNL000's)       |                  |                 |                |
| Interest income                                     | 4,295,960        | 3,711,898        | 584,062         | 15.7%          |
| Interest expense                                    | 2,053,671        | 1,691,374        | 362,297         | 21.4%          |
| <b>Financial profit</b>                             | <b>2,242,289</b> | <b>2,020,524</b> | <b>221,764</b>  | <b>11.0%</b>   |
| Loan impairment charges                             | 306,152          | 391,671          | (85,519)        | (21.8%)        |
| <b>Financial profit, net of impairment charges</b>  | <b>1,936,137</b> | <b>1,628,853</b> | <b>136,245</b>  | <b>18.9%</b>   |
| Income from insurance activities                    | 1,749,981        | 1,590,871        | 159,110         | 10.0%          |
| Expenses from insurance activities                  | 1,499,078        | 1,365,142        | 133,936         | 9.8%           |
| <b>Profit from insurance activities</b>             | <b>250,903</b>   | <b>225,729</b>   | <b>25,174</b>   | <b>11.2%</b>   |
| Services                                            | 77,710           | 173,303          | (95,593)        | (55.2%)        |
| Commissions                                         | 1,603,344        | 709,491          | 893,853         | 126.0%         |
| Leases                                              | 86,672           | 86,612           | 60              | 0.1%           |
| Other income                                        | 252,044          | 123,602          | 128,442         | 103.9%         |
| <b>Total Proceeds from services</b>                 | <b>2,019,770</b> | <b>1,093,008</b> | <b>926,762</b>  | <b>84.8%</b>   |
| Staff-expenses                                      | 1,157,382        | 791,835          | 365,547         | 46.2%          |
| General and administrative expenses                 | 1,745,970        | 1,176,399        | 569,571         | 48.4%          |
| Depreciation and amortization                       | 292,607          | 311,013          | (18,406)        | (5.9%)         |
| <b>Total other expenses</b>                         | <b>3,195,959</b> | <b>2,279,246</b> | <b>916,713</b>  | <b>40.2%</b>   |
| <b>Operating income</b>                             | <b>1,010,851</b> | <b>668,344</b>   | <b>171,468</b>  | <b>51.2%</b>   |
| Income from dividends                               | 21,868           | 150,029          | (128,161)       | (85.4%)        |
| Gain on sale of other and contingent assets .....   | 51,066           | 30,036           | 21,030          | 70.0%          |
| Gain on sale of fixed assets                        | 6,422            | 6,700            | (279)           | (4.2%)         |
| Other income, net                                   | 162,612          | 126,376          | 36,236          | 28.7%          |
| <b>Total non-operating income (expenses)</b>        | <b>241,967</b>   | <b>313,140</b>   | <b>(71,173)</b> | <b>(22.7%)</b> |
| <b>Income before income tax</b>                     | <b>1,252,818</b> | <b>981,485</b>   | <b>271,333</b>  | <b>27.6%</b>   |
| Income tax/capital gain/net assets tax              | 445,584          | 333,540          | 112,044         | 33.6%          |
| <b>Income before minority interest</b>              | <b>807,235</b>   | <b>647,945</b>   | <b>159,289</b>  | <b>24.6%</b>   |
| Net income attributable to noncontrolling interests | 136,151          | 55,381           | 80,770          | 145.8%         |
| <b>Net Income</b>                                   | <b>671,084</b>   | <b>592,564</b>   | <b>78,519</b>   | <b>13.3%</b>   |

An analysis of the components of our consolidated income statement set forth in the foregoing table follows.

## Financial proceeds

The following table presents the components of our interest income for the six months ended June 30, 2019 and 2018.

|                               | June 30,         |                  | Change         |              |
|-------------------------------|------------------|------------------|----------------|--------------|
|                               | 2019             | 2018             |                |              |
| Interest Income               | (HNL's)          |                  | (HNL's)        | %            |
| Loans                         | 3,825,888        | 3,213,595        | 612,293        | 19.1%        |
| Investments Securities        | 429,380          | 474,357          | (44,977)       | (9.5%)       |
| Interest earning deposits     | 40,692           | 23,946           | 16,746         | 69.9%        |
| <b>Total, interest income</b> | <b>4,295,960</b> | <b>3,711,898</b> | <b>584,062</b> | <b>15.7%</b> |

Interest income increased 15.7% to L4,295,960 for the six months ended June 30, 2019, from L3,711,898 for the corresponding period 2018. This increase in interest income was mainly due to an increase in interest income from loans to 19.1% and deposits that generate interest to 69.9%.

Interest on our loan portfolio increased by L612,293 or 19.1%, for the six months ended June 30, 2019 compared to the corresponding period 2018, mainly due to a higher volume of loans disbursed in local currency whose average balance grew by 26.0% compared to the six months ended June 30, 2018. The average balance of loans denominated in US dollars portfolio, as of June 2019 increased 18.2% compared to June 30, 2018. This is due to the growth of the year-on-year portfolio of L9,129 million in local currency and L4,152 million in foreign currency.

Interest on securities investments decreased by L44,977, or 9.5%, for the six months ended June 30, 2019 compared to the corresponding period in 2018, mainly due to a decrease in the average balance of investments 3.3% for the six months ended June 30, 2019 compared to the six months ended June 30, 2018.

## Interest expense

The following table presents the components of our interest expense for the six months ended June 30, 2019 and 2018.

|                               | June 30,         |                  | Change         |              |
|-------------------------------|------------------|------------------|----------------|--------------|
|                               | 2019             | 2018             |                |              |
| Interest expense              | (HNL's)          |                  | (HNL's)        | %            |
| Deposits from customers       | 1,401,122        | 1,195,902        | 205,220        | 17.2%        |
| Loans obtained from banks     | 413,419          | 307,362          | 106,057        | 34.5%        |
| Financial obligations         | 239,130          | 188,110          | 51,020         | 27.1%        |
| <b>Total interest expense</b> | <b>2,053,671</b> | <b>1,691,374</b> | <b>362,297</b> | <b>21.4%</b> |

Interest expenses increased by L362,297 thousand to L2,053,671 thousand for the six months ended June 30, 2019 from L1,691,374 thousand for the corresponding period in 2018, mainly due to an increase in deposits in checking, savings, term and restricted accounts, increased indebtedness for credit portfolio financing and the issuance and placement of guaranteed notes of Banco Atlántida and Banco Atlántida El Salvador.

Interest expense on customer deposits increased by L205,220 thousand, or 17.2%, for the six months ended June 30, 2019 compared to the corresponding period in 2018, is correlated with the loan demand the bank has faced, requiring additional funding that has readily been available through term deposits, which has grown by HNL 149,838 thousand for the six months ended June 30, 2019 compared to the six months ended



on June 30, 2018. Interest expense from savings accounts have increased HNL 35,815 thousand as of June 30, 2019 compared to the previous year.

Interest expense on loans obtained from banks increased by L106,057 thousand, or 34.5%, for the six months ended June 30, 2019 compared to the corresponding period in 2018. mainly as a result of our decision to increase loans from international financial institutions in order to match the funds with our long-term loans to clients in foreign currency.

Interest expense on financial obligations increased by L51,020 thousand, or 27.1%, for the six months ended June 30, 2019, compared to the corresponding period in 2018, mainly due to an increase in interest expenses of BAES by L 27,383 thousand, Banco Atlántida by L15,100 thousand and Invatlan by L8,528 thousand. This increase in expenses was due to bond emissions of BAES by USD50,000 thousand issued on July 2018, new bond emissions by Banco Atlántida for L695 million in local currency and L805 million (USD 33.6 million) in US\$ and as an effect of rate exchange variation in foreign currency over bonds issued by Invatlan.

#### **Allowance for loan and interest losses**

The following table presents our loan impairment charges, NPL ratio, our coverage ratio and our loan and Provision for loan losses (PLL)for the three months ended June 30, 2019 and 2018

|                           | June 30,   |           |            |         |
|---------------------------|------------|-----------|------------|---------|
|                           | 2019       | 2018      | Change     |         |
|                           | (HNL000's) |           | (HNL000's) | %       |
| Loan impairment charges   | 306,152    | 391,671   | (85,519)   | (21.8%) |
| NPL ratio                 | 2.4%       | 2.8%      | -          | -       |
| Coverage ratio            | 122.0%     | 125.8%    | -          | -       |
| Provision for loan losses | 2,058,628  | 2,083,346 | (24,718)   | (1.2%)  |

Credit impairment charges decreased by 21.8% or L85,519 thousand for the six months ended June 30, 2019 of L391,671 thousand for the corresponding period in 2018. The delinquency rate decreased to 2.4% as of June 30, 2019 from 2.8% as of June 30, 2018. The coverage ratio decreased to 122.0% as of June 30, 2019, compared with 125.8% as of June 30, 2018.

During the six months ended June 30, 2019, loan impairment charges attributable to our retail banking products decreased to L 87,039 compared to L 293,563 as of June 30, 2018, mainly after the Bank modified its credit policies, particularly those of the consumer loan portfolio with a focus on the applicant's credit scores and models to predict default, complementing this effort with an active recovery team and external recovery agencies. This strategy has yielded positive results and the reserves for bad loans for the consumer loan portfolio have decreased by HNL 206,800 thousand as of June 30, 2019 compared to the expenses recorded as of June 30, 2018.

During the six months ended June 30, 2019, loan impairment charges attributable to our SME banking segment increased to L137,097 thousand, or 691.2% compared to L17,327 thousand recognized as expense, as of June 30, 2018, primarily due to the conditions surrounding specific economic sectors such as poultry, coffee and palm oil which have either been impacted by weather conditions or international commodity prices.

### Proceeds from services

The following table presents the components of our fee and commission income for the six months ended June 30, 2019 and 2018

|                                     | June 30,         |                  | Change         |              |
|-------------------------------------|------------------|------------------|----------------|--------------|
|                                     | 2019             | 2018             | (HNL000's)     | %            |
|                                     | (HNL000's)       |                  |                |              |
| Services                            | 77,710           | 173,303          | (95,593)       | (55.2%)      |
| Commissions                         | 1,603,344        | 709,491          | 893,853        | 126.0%       |
| Leases                              | 86,672           | 86,612           | 60             | 0.1%         |
| Other income                        | 252,044          | 123,602          | 128,442        | 103.9%       |
| <b>Total proceeds from services</b> | <b>2,019,770</b> | <b>1,093,008</b> | <b>926,762</b> | <b>84.4%</b> |

Service revenues increased 84.4% or L926,762 thousand for the six months ended June 30, 2019 from L1,093,008 thousand for the corresponding period in 2018, mainly due to the increase in commission income to 126.0% and others revenue to 103.9%.

The decrease in income from services of L95,593 thousand, or 55.2%, to L77,710 for the six months ended June 30, 2019 from L173,303 thousand for the corresponding period in 2018 was caused by reclassifications of several accounts to Other Income by L122,875 thousand, in order to improve the presentation of financial information. These reclassifications affected Other Income in a positive way, therefore, to better analyze both accounts we compare the balances together, resulting in an increase of L32,849 thousand, which is mainly due to an increase of L26,911 thousand in revenues from COALSA's operative leasing.

The increase in commissions of L893,853 thousand, or 126.0%, to L1,603,344 for the six months ended June 30, 2019 from L709,491 thousand for the corresponding period in 2018 was mainly due (1) the incorporation of AFP CONFIA commissions income for L791,229, (2) AFP had an increase of L 18,673 in other operating income, and (3) Banco Atlántida had an increase of L78,366, on its credit card revenues.

### Income from insurance activities

The following table presents the components of our net premium income for the six months ended June 30, 2019 and 2018

|                                         | June 30 (in Thousands of Lempiras) |                |               |              |
|-----------------------------------------|------------------------------------|----------------|---------------|--------------|
|                                         | 2019                               | 2019           | Change        |              |
|                                         |                                    |                | (Absolute)    | %            |
| Income from insurance activities        | 1,749,981                          | 1,590,871      | 159,110       | 10.0%        |
| Expenses from insurance activities      | 1,499,078                          | 1,365,142      | 133,936       | 9.8%         |
| <b>Profit from insurance activities</b> | <b>250,903</b>                     | <b>225,729</b> | <b>25,174</b> | <b>11.2%</b> |

Income from insurance activities increased by 11.2% or L25,174 thousand, for the six months ended June 30, 2019. This growth of 11% in income from insurance activities, was due mainly to a release of technical reserves for an amount of L.27.8 million compared to the same period of the previous year. Salvages and recoveries were also increased by 11.86%.

Revenue from insurance activities increased by 9.8% or L159,110 thousand for the six months ended June 30, 2019, compared to the corresponding period in 2018. This growth is mainly due to the increase in revenues due to variation in technical reserves for 42.67%, as well as an increase in technical revenue of L.2.2 million, this compared to June 30, 2018. Net insurance premiums decreased 2.73%, during the year of 2019 compared to the same period of 2018.

Expenses for insurance activities increased by 9.8% or L133,936 thousand for the six months ended June 30, 2019 compared to the corresponding period in 2018, mainly due to a 32.86% increase in expenses for canceled premiums.

### Other expenses

The following table presents the components of our operating and administrative expenses for the six months Ended June 30, 2019 and 2018

|                                     | In Thousands of Lempiras (except the percentages) |                  |                |              |
|-------------------------------------|---------------------------------------------------|------------------|----------------|--------------|
|                                     | June 2019                                         | June 2018        | Change         |              |
| <b>Other expenses:</b>              |                                                   |                  |                |              |
| Staff expenses                      | 1,157,382                                         | 791,835          | 365,547        | 46.2%        |
| General and administrative expenses | 1,745,970                                         | 1,176,399        | 569,571        | 48.4%        |
| Depreciations and amortizations     | 292,607                                           | 311,013          | (18,406)       | (5.9%)       |
| <b>Total, other expenses</b>        | <b>3,195,959</b>                                  | <b>2,279,247</b> | <b>916,713</b> | <b>40.2%</b> |

Other expenses increased 40.2% or L916,713 thousand for the six months ended June 30, 2019 compared to L2,279,247 thousand for the corresponding period in 2018. The increase in other expenses was mainly due to (1) an increase in 46.2% in Personnel expenses, (2) an increase of 48.4% in general and administrative expenses.

The increase in staff expenses of L365,547 thousand, or 46.2%, for the six months ended June 30, 2019 compared to the corresponding period in 2018 was mainly due to the incorporation of staff expenses of CONFIA, company which was acquired through Inversiones Financieras Atlántida, SA, which contributed an additional expense of L141,174 thousand, Banco Atlántida recorded an increase in staff expenses of L135,384 thousand, Banco Atlántida El Salvador recorded and increase by L39,857 thousand and Servicios Atlántida also recorded an increase of L19,643 thousand.

The increase in general and administrative expenses of L569,571 thousand, or 48.4%, for the six months ended June 30, 2019 compared to the corresponding period in 2018, was mainly due to the following: (1) the incorporation of the general and administrative expenses of AFP CONFIA acquired through Inversiones Financieras Atlántida, SA for a total of L 440,165 thousand; (2) an increase of L 10,902 thousand in general and administrative expenses of AFP Atlántida in relation to a greater investment in marketing and advertising (3) an increase of L58,756 thousand in general and administrative expenses of Banco Atlántida, SA.

### Non-operating income (expenses)

The following table presents the components of our Non-operating income (expenses) for the six months ended June 30, 2019 and 2018.

|                                   | In thousands of lempiras (except the percentages) |                |                 |                |
|-----------------------------------|---------------------------------------------------|----------------|-----------------|----------------|
|                                   | June 2019                                         | June 2018      | Change          |                |
| Income from dividends             | 21,868                                            | 150,029        | (128,161)       | (85.4%)        |
| Gain on sale of foreclosed assets | 51,066                                            | 30,036         | 21,030          | 70.0%          |
| Gain on sale of fixed assets      | 6,422                                             | 6,700          | (279)           | (4.2%)         |
| Other income, net                 | 162,612                                           | 126,376        | 36,236          | 28.7%          |
| <b>Total</b>                      | <b>241,968</b>                                    | <b>313,141</b> | <b>(71,173)</b> | <b>(22.7%)</b> |

Non-operating income decreased by L71,173 or 22.7% during the six months ended June 30, 2019 compared to the corresponding period in 2018.

Dividend income decreased by L 128,161 thousand, as compared to June 2018, when Inversiones Atlántida S.A. received L127,239 in dividends from CIA (Corporación de Inversiones Atlántida) and in 2019 no dividends were received from CIA.

Gains from the sale of foreclosed assets increased by L21,030 or 70.0% during the six months ended June 30, 2019 compared to the same period in 2018.

Other net income increased by L36,236 or 28.7% compared to the same period of 2018, mainly due to the following: (1) an increase in other revenue due to a reversal on investment reserves by the amount of L67,470 thousand. (2) an increase in exchange rate variation of (L16,322) thousand and (3) a decrease on income by recovered financial assets previously written off, by (L8,293) thousand and a decrease on other net income and expense by (L8,606) thousand.

## Net Income

Earnings before income tax increased 27.6% and stood at L1,252,818 thousands for the six months ended June 30, 2019, compared to L 981,485 thousand for the corresponding period in 2018.

## Income Tax

Income tax expense increased by L112,044 thousand, or 33.6%, for the six months ended June 30, 2019, as compared to the corresponding period in 2018. The effective income tax rate as of June 30, 2019 was 35.6% while as of June 30, 2018 was 34.0%.

## Liquidity and Funding

Banco Atlántida represents our primary source of funds, and its liquidity comes from client deposits, loans from banks and financial institutions and debt securities.

The following table sets forth our primary sources of funding on a consolidated basis as of June 30, 2019 and as of June 30, 2018.

|                                   | As of June 30, (HNL000's) |                   |                  |              |
|-----------------------------------|---------------------------|-------------------|------------------|--------------|
|                                   | 2019                      | 2018              | Change           | %            |
| Demand Deposits                   | 10,917,601                | 9,728,182         | 1,189,419        | 12.2%        |
| Term Deposits                     | 34,316,308                | 26,174,956        | 8,141,352        | 31.1%        |
| Saving Deposits                   | 31,474,034                | 32,537,849        | (1,063,815)      | (3.3%)       |
| Others                            | 476,081                   | 415,057           | 61,024           | 14.7%        |
| <b>Total deposits</b>             | <b>77,184,024</b>         | <b>68,856,044</b> | <b>8,327,980</b> | <b>12.1%</b> |
| Loans and borrowings from banks   | 10,324,465                | 12,474,913        | (2,150,448)      | (17.2%)      |
| Corporate bonds and secured notes | 6,181,426                 | 5,839,697         | 341,729          | 5.9%         |
|                                   | <b>93,689,915</b>         | <b>87,170,654</b> | <b>6,519,261</b> | <b>7.5%</b>  |

Banco Atlántida's main sources of funds have traditionally consisted of deposits and loans from banks, as well as issued debt securities.

Total deposits increased by 12.1% or L8,327,980 thousand as of June 30, 2019, compared to the same period in 2018, mainly due to a 31.1% increase in term deposits.

Loans obtained from other banks included short-term commercial financing, credit lines and long-term loans from international financial institutions and multilateral organizations. Banco Atlántida has

lines of credit with 17 global financial institutions with which it has maintained correspondent relations for a long time.

As of June 30, 2019, we had a total amount of US\$330,679 thousand (L8,103,859 thousand) in non-committed credit lines of foreign institutions on a consolidated basis, of which US\$215,878 thousand (L5,290,454 thousand) were Available for use.

Corporate bonds and guaranteed bonds issued, amounted to L6,181,426 thousand as of June 30, 2019, compared to L5,839,697 thousand as of June 30, 2018, representing an increase of 5.9%, mainly due to an issue of corporate bonds of Banco Atlántida for HNL813 million and US\$33.1 million (HNL808.5 million) net of HNL880.0 million in redeemed bonds during the year, to finance business and for corporate purposes in general. The conditions include a term of 3 to 5 years with a single payment at expiration, while the interest rate is set between 7.5% and 10.5% per year for bonds in HNL, and between 3.5% and 6.0% per year, for corporate bonds in USD. Quarterly interest based on the overdue period.

Additionally, Banco Atlántida El Salvador, SA issued bonds called "CIBAES1" for an amount of up to US\$50,000 (HNL1,228 million). The conditions include a term of 5 years with a single capital payment at expiration and semiannually interest payments. This bonds interest rate is described as following:

- From 31/07/2018 to 30/07/2019: 4.50%
- From 31/07/2019 to 30/07/2020: 5.50%
- From 31/07/2020 to 30/07/2021: 6.50%
- From 31/07/2021 to 30/07/2022: 7.50%
- From 31/07/2022 until maturity: 8.00%.

Through our asset and liability management policy, we seek to ensure that there is enough liquidity available to meet deposit withdrawals, pay other liabilities at maturity, grant loans or other forms of credit to customers, pay liabilities derived from insurance policies that we issue, and meet the needs of working capital. The minimum amount of liquidity that our main subsidiaries must maintain depends on the reserve requirements established by the Central Bank, as well as the legal, technical and mathematical reserves required by our insurance operations. We comply with these requirements maintaining an adequate balance between the maturity profile and the diversity of our funding sources.

We expect the deposits, loans and loans from banks and debt securities issued to be enough to meet our liquidity requirements in the next 12 months.

## Regulatory Capital

As a holding company, we are not obliged to maintain regulatory capital in a consolidated manner. However, in accordance with the Honduran regulatory capitalization requirements, Banco Atlántida must maintain specific levels of capital as a percentage of its risk-weighted assets (capital adequacy ratio) of 10.75% or more. As of June 30, 2019, the capital adequacy ratio of Banco Atlántida S.A., was 12.2% and 12.4% as of June 30, 2018.

The following table sets forth Banco Atlántida's capital on an unconsolidated basis as compared to the minimum capital requirements as of the dates indicated.

|                                                            | June 30    | Of December 31, (in thousands of Lempiras) |            |            |
|------------------------------------------------------------|------------|--------------------------------------------|------------|------------|
|                                                            | 2019       | 2018                                       | 2017       | 2016       |
| Total, Tier 1                                              | 7,988,863  | 7,488,863                                  | 6,488,863  | 5,686,163  |
| Total, Tier 2                                              | 1,273,852  | 1,361,627                                  | 1,018,734  | 987,762    |
| Total, Regulatory capital                                  | 9,262,715  | 8,850,490                                  | 7,507,597  | 6,673,925  |
| Total, Risk weighted assets                                | 75,787,769 | 71,545,025                                 | 61,083,980 | 53,877,580 |
| Regulatory Capital as a percentage of risk weighted assets | 12.2       | 12.4                                       | 12.3       | 12.4       |

## Commitments and contractual obligations

The following table summarizes our commitments and contractual obligations as of June 30, 2019:

| (L in thousands, except percentages)    | Less than 30 days | 31 to 90 days     | 91 to 1 year      | Between 1 and 5 years | More than 5 years | Total             |
|-----------------------------------------|-------------------|-------------------|-------------------|-----------------------|-------------------|-------------------|
| Deposits and obligations from customers | 10,242,925        | 13,883,483        | 14,274,831        | 21,328,881            | 17,453,904        | 77,184,024        |
| Loans and borrowings from banks         | 754,397           | 678,677           | 2,265,635         | 3,887,089             | 2,738,667         | 10,324,465        |
| Debt securities issued                  | -                 | -                 | -                 | 5,691,292             | 490,134           | 6,181,426         |
| <b>Total</b>                            | <b>10,997,322</b> | <b>14,562,160</b> | <b>16,540,466</b> | <b>30,907,262</b>     | <b>20,682,705</b> | <b>93,689,615</b> |
| <b>% of Total</b>                       | <b>11.7%</b>      | <b>15.5%</b>      | <b>17.7%</b>      | <b>33.0%</b>          | <b>22.1%</b>      | <b>100.0%</b>     |

## Capital expenditures

Our consolidated capital expenditures add to the amount of L123,514 thousand for the six months ended June 30, 2019 and L172,526 thousand lempiras for the six months ended June 30, 2018. Our subsidiaries made significant investments in information technology to provide quality services to our customers.

## Off-Balance sheet arrangements

In the normal course of operations of the Group, there are several commitments, derived from securities, letters of credit, etc., which are not reflected in the consolidated financial statements. The Group does not expect any losses resulting from the development of these transactions. These contingent liabilities are detailed as follows:

|                                             | June 30, 2019      | December 31, 2018   |
|---------------------------------------------|--------------------|---------------------|
| Letters of credit and idle credit documents | L 312,412          | 362,969             |
| Sureties and bank guarantees issued         | 4,419,602          | 5,659,985           |
| Acceptance debtors                          | 549,117            | 742,965             |
| Idle credits                                | 4,604,071          | 4,354,232           |
| Miscellaneous responsibilities              | 25,960             | -                   |
|                                             | <b>L 9,911,162</b> | <b>L 11,120,151</b> |

## Qualitative and Quantitative Disclosure about Market Risks

The Group is exposed to risks in the ordinary course of business, particularly credit risk, liquidity risk, exchange rate risk and interest rate risk. For a discussion on how the exposure to these risks is regularly assessed and managed, see note 4 to the consolidated financial statements.