BRC Ratings

A Company of S&P Global

Colombia

Rating Report

CREDIVALORES - CREDISERVICIOS S. A.

Originator

This English version is provided on request and reflects the translation from the original one provided only in Spanish by BRC Ratings – S&P Global S.A. Sociedad Calificadora de Valores on May 15, 2023. In case of any discrepancy between this English version and the original in Spanish, the Spanish version shall apply.

Contacts:
Diego Eichmann Botero
diego.botero@spglobal.com
Luis Carlos López
luis.carlos.lopez@spglobal.com

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I. RATING ACTION

BRC Ratings - S&P Global S. A. Sociedad Calificadora de Valores downgraded the rating of Credivalores - Crediservicios S. A. (hereinafter, Credivalores) to ori BBB- from ori A, withdrew the negative outlook and assigned CreditWatch with negative implications.

An outlook assesses a potential rating change over the long term and incorporates trends or risks with less certain implications for Credivalores' performance. The negative outlook indicates that the rating may be downgraded or maintained over a period of one to two years.

CreditWatch indicates our view of the potential direction of a rating on an entity or issue when an event or deviation from expected trend occurs, or is expected to occur, and we require additional information to take a rating action. Particularly, a CreditWatch status with negative implications indicates that the consequences of certain future events are uncertain and that, as a result of their resolution, the rating could potentially be downgraded.

The originator rating is understood as a complement to the credit risk rating and is not an assessment of payment capacity. Although it incorporates criteria related to the financial strength of an entity, it also includes qualitative factors associated with its ability to originate and manage credit assets, such as the suitability of its organizational structure, the quality of its origination, underwriting or disbursement policies and processes, or its risk management and internal control mechanisms.

II. RATING RATIONALE:

Credivalores is one of the main non-bank financial institutions (NBFI) in Colombia and it specializes in granting consumer credit to low and middle-income debtors in intermediate cities and rural areas, where there is no traditional banking presence. Over the last year, the company has been able to meet all of its financial obligations, for approximately US$215 million, within an operating environment characterized by high risk aversion in the debt market and limited confidence in Latin America’s NBFIs. Particularly, the entity obtained financing through a mixture of capitalizations, credit lines collateralized with credit assets, operations in the international and local capital markets, and debt contracted with its shareholders.

The downgrade of Credivalores' originator rating and CreditWatch with negative implications shows the weakening of its financial profile, which constrains our assessment of its ability to sustain the profitable growth of its business in the long term. In particular, the rating action considers a material change compared to our expectations regarding the losses incurred by the company, which totalled $302,459 million Colombian pesos (COP) and resulted in an equity deficiency of COP56,433 million as of December 2022. This is mainly explained by the materialization of exchange risks on the entity's obligations in dollars, an aspect that deepened structural weaknesses for the internal generation of capital identified in past reviews. In this sense, we consider that the high sensitivity of Credivalores to the foreign exchange rate and the assumption of strong volatility in its financial results show a greater risk appetite compared to past reviews.

That rating action does not incorporate changes in our opinion on qualitative factors related to its ability to originate and manage credit assets, such as the adequacy of its organizational structure, the quality of its origination, underwriting or disbursement policies and processes, or its mechanisms of risk management and internal control. In this sense, our evaluation incorporates Credivalores' 20-year track record as a credit originator focused on consumer segments not covered by traditional banks and its specific knowledge of the payroll loan market.

The restrictive funding conditions, the lower availability of eligible assets to fund the loan book and the entity's need to maintain cash to cover debt maturities led to a 6.1% decrease in Credivalores' loan portfolio during 2022, which continued to pressure its interest income and exacerbated weaknesses on its profitability. This, coupled with the higher cost of funding, the limitations on the speed of the repricing of its assets due to the slower rate of new placements and its growing provision expenses, had a strong impact on the company's operating results. As of December 2022, the operating loss before taxes, excluding accounting losses due to foreign exchange differences, reached around COP100,000 million, which shows the operating deterioration of its business. Likewise, the entity's 12-month return on assets (ROA) was -11.2%, widely below 1.5% for the banking sector and less than its average of 0.2% between 2019 and 2021.

Due to the strong volatility in Credivalores' financial results, the equity-to-asset ratio contracted to -2.2% in December 2022 from 10.4% a year ago. Likewise, the capitalization indicator (IC – equity over net loan portfolio) decreased to -4.3% from 18.1%, below the level of 13.5% required by the covenants of the 144A / Reg S notes, which restricts the ability to the company to take on additional debt. As a result, the shareholders of Credivalores announced a capitalization of US$57 million scheduled for May 2023, which would take place through a debt-to-equity conversion and includes the entry of a new majority shareholder and the appointment of a new president for the company. Under our base-case scenario, this operation would increase the entity's equity-to-assets ratio to a level close to 10%, depending on the evolution of the foreign exchange rate. However, its capital and leverage ratios would continue to be modest, particularly given its deficiency in internal capital generation and high exposure to market risks.

As of December 2022, credit cards continued to gain participation in the loan portfolio managed by Credivalores, reaching 52.8% of the total, while the payroll loan balance contracted 11.7% annually and represented 45.2% of the managed credit portfolio, 3.6 percentage points lower than the June 2022 cut-off. The economic slowdown environment, as well as the persistence of high levels of interest rates and inflation, continued to put pressure on the quality of the loan book. In this sense, most of the deterioration is explained by the increase in the representativeness of credit cards, whose past-due loan portfolio indicator with a delinquency between 30 and 360 days (ICV, for its Spanish acronym) increased one percentage point to 10.5% between June and December 2022. In line with its lower relative credit risk, the payroll loans product was less sensible with an ICV that increased to 4.6% from 4.4%; however, this record is still high compared to the average of 2.5% of credit establishments.

On the other hand, Credivalores past-due loan coverage ratio of around 100%, calculated using the international financial reporting standards -IFRS- 9, continues to be below the one observed for consumer products in the banking sector of approximately 160%. In our opinion, such levels of coverage imply that Credivalores has a lower capacity to absorb adverse scenarios in the quality of its assets with respect to the banking industry, as well as compared to other entities that originate consumer credit. Although this condition is partially mitigated by the participation of payroll loans in Credivalores' balance sheet, we consider that the quality of the credit card portfolio would have a greater impact. Our expectations for 2023 consider additional pressure on the coverage indicator associated with a deterioration in the quality of the consumer loans portfolio in the sector. This, coupled with Credivalores' negative operating result in 2022, will probably continue to limit its ability to reduce the gap in its coverage metrics compared to supervised entities.

According to Credivalores, the entity will seek to focus its efforts on the origination of payroll loans, an aspect that should contribute to increasing its relative participation in the total loan portfolio compared to credit cards. While this has the potential to benefit the company's asset quality over the next 12-18 months, implementing the strategy involves execution risks, which may be exacerbated given the challenging macroeconomic environment. With the change in its shareholding structure, the entity will have a transition period under a management committee made up of its shareholders that will support the new CEO (still pending appointment at the date of preparation of this report) in his duties.

Since our last review in October 2022, Credivalores completed the exchange of 30% of the notes of the XVI tranche of the ECP program and 72% of the XVII tranche. The company also closed a one-year line with its shareholders for US$20 million with shares as backing. This allowed the entity to access enough resources to meet its remaining maturities in 2022 and meet its commitments for the first quarter of 2023. According to the Credivalores management team, at the end of April 2023, it had a cash balance of close to COP137,000 million. These resources, together with its partially guaranteed issuances in the local market, the collateralized financing facilities, and its lines of working capital, would give the company sufficient capacity to cover the payment of US$15 million for the maturity of the notes of the XVIII tranche of the ECP Program in October 2023. Even though the company still has maturities for US$268 million concentrated in 2025, we believe that this, along with the announced capitalization, will result in lower leverage levels and a funding structure with less exposure to foreign financing.

The materialization of negative CreditWatch will be subject to the sensitivity shown by Credivalores' equity to market risk and the evolution of its capital metrics after the capitalization announced for May 2023. In addition, it will also consider the effects on the company derived from the change in its shareholders and the implementation of its new business plan with a greater emphasis on payroll loans. Maintaining a deficient capacity for internal capital generation, related to the low growth dynamics of its loan portfolio and/or pressures on its financial cost, could lead to additional reductions in the entity's rating. Likewise, additional deterioration in the quality of its assets beyond our expectations and/or the sustained increase in the participation of credit cards in the company's balance sheet would also pressure down its rating.

This extraordinary review was based on the information available from Credivalores, our analysis and estimates on the projections submitted by the qualified party, among other aspects. As a result of the above, substantial changes in said elements could lead us to modify our opinion in the future.

III. FACTORS THAT COULD MODIFY THE RATING:

What could lead us to upgrade the rating

- The adequate execution of Credivalores' business transformation strategy that allows improving the quality of its assets, consistently increasing its internal capital generation, and strengthening its capital metrics.

What could lead us to downgrade the rating

- The sustained slowdown in the growth of the company's loan portfolio that weakens its business position and continues to limit its capacity to generate internal capital.
- The materialization of market risks related to the entity's exposure to foreign currency that continue to weaken the company's capital metrics.
- The deepening of the deterioration of the loan quality and coverage indicators outside the behaviour of the industry and/or our expectations.
- A weakening of Credivalores' balance sheet structure related to sustained pressures on its funding.

IV. ADDITIONAL INFORMATION:

Type of rating	Originator
Minute number	2324
Date of the Committee	May 15, 2023
Type of Review	Extraordinary review
Administrator	CREDIVALORES - CREDISERVICIOS S. A.
Members of the Committee	Andrés Marthá Martinez
	María Soledad Mosquera Ramírez
	María Carolina Barón Buitrago

Rating history

Extraordinary review Oct./22: ori A; negative outlook
Extraordinary review May/22: ori AA; negative outlook
Initial rating assignment May/12: ori AA-

The technical visit for the rating process was carried out in a timely manner thanks to the availability of the originator and the delivery of the information that was met in accordance with the minimum requirements of BRC Ratings – S&P Global SA Sociedad Calificadora de Valores.

BRC Ratings – S&P Global SA Sociedad Calificadora de Valores does not perform audit functions, therefore, the entity's management takes full responsibility for the integrity and veracity of all the information provided and that has served as the basis for the preparation of this report. On the other hand, BRC Ratings – S&P Global SA Sociedad Calificadora de Valores reviewed the available public information and compared it with the information provided by the entity.

The financial information included in this report is based on the audited financial statements for the last three years and unaudited as of December 2022.

If you have any question regarding the indicators included in this document, you can consult the glossary at www.brc.com.co

To see the definitions of our ratings, visit www.brc.com.co or click here.

V. FINANCIAL STATEMENTS:

CREDIVALORES - CREDISERVICIOS S. A.
BALANCE SHEET (Expressed in Millions of COP)

	Dec-19	Dec-20	Dec-21	Dec-22	Var % Dec-20 / Dec- 21	Var % Dec-21 / Dec- 22
Cash and cash equivalents	**163,851**	**264,299**	**148,514**	**273,052**	**-43.8%**	**83.9%**
Total assets at fair value	**238,869**	**280,397**	**377,965**	**104,940**	**34.8%**	**-72.2%**
Net loan portfolio	**1,237,974**	**1,485,834**	**1,715,871**	**1,632,832**	**15.5%**	**-4.8%**
Consumer loans	1,424,958	1,747,034	2,034,298	2,005,440	16.4%	-1.4%
Microcredit loans	5,863	5,772	-	-	-100.0%	
Provisions for loan losses	(192,847)	(266,972)	(318,427)	(372,608)	19.3%	17.0%
Accounts receivable	**386,189**	**429,297**	**436,872**	**320,129**	**1.8%**	**-26.7%**
Total financial assets at amortized cost	**1,624,163**	**1,915,131**	**2,152,743**	**1,952,961**	**12.4%**	**-9.3%**
Investments in associated companies	10,963	10,966	12,369	14,945	12.8%	20.8%
Current tax assets	13,542	14,858	22,245	32,012	49.7%	43.9%
Deferred tax assets, net	11,053	5,961	43,409	157,736	628.2%	263.4%
Property, plant and equipment, net	1,159	575	229	173	-60.2%	-24.5%
Intangible assets other than goodwill, net	53,892	55,452	44,111	39,852	-20.5%	-9.7%
Right-of-Use assets	5,902	6,020	4,298	2,021	-28.6%	-53.0%
Total assets	**2,123,394**	**2,553,659**	**2,805,883**	**2,577,407**	**9.9%**	**-8.1%**
Derivative instruments	**32,188**	**16,791**	**316**	**-**	**-98.1%**	**-100.0%**
Financial obligations	**1,643,578**	**2,015,402**	**2,422,009**	**2,536,407**	**20.2%**	**4.7%**
Salaries and other employee benefits	1,105	983	995	1,053	1.2%	5.8%
Other provisions	476	7,370	918	3,028	-87.5%	229.8%
Accounts payable	100,273	153,330	79,065	51,892	-48.4%	-34.4%
Current tax liabilities	1,244	2,043	1,969	1,698	-3.6%	-13.8%
Other liabilities	61,833	49,568	42,000	40,057	-15.3%	-4.6%
Total liabilities	**1,840,697**	**2,245,487**	**2,547,272**	**2,634,135**	**13.4%**	**3.4%**
Total equity	**282,697**	**308,172**	**258,611**	**(56,443)**	**-16.1%**	**-121.8%**

CREDIVALORES - CREDISERVICIOS S. A. INCOME STATEMENT (Expressed in Millions of COP)	Dec-19	Dec-20	Dec-21	Dec-22	Var % Dec-20 / Dec- 21	Var % Dec-21 / Dec- 22
Interest income and similar	275,186	290,980	321,174	286,766	10.4%	-10.7%
Interest expenses	(191,824)	(186,988)	(235,607)	(304,011)	26.0%	29.0%
Net interest income and similar	**83,362**	**103,992**	**85,567**	**(17,245)**	**-17.7%**	**-120.2%**
Provisions for loan losses	(47,456)	(80,582)	(67,500)	(75,369)	-16.2%	11.7%
Write-offs	(15,865)	(12,008)	(14,322)	(8,370)	19.3%	-41.6%
Provisions for other accounts receivable	(6,495)	(9,028)	(13,860)	(11,298)	53.5%	-18.5%
Loan recoveries	1,337	604	872	2,054	44.4%	135.6%
Other recoveries	132	-	19	-		-100.0%
Net Interest income after impariments and recoveries	**15,015**	**2,978**	**(9,224)**	**(110,228)**	**-409.7%**	**1095.0%**
Interest and dividend income	478	3,535	937	7,566	-73.5%	707.5%
Fair value gains (losses) of investments	(4,240)	(101)	(44)	(9)	-56.4%	-79.5%
Net investment income	**(3,762)**	**3,434**	**893**	**7,557**	**-74.0%**	**746.2%**
Currency exchange difference	412	4,093	844	(309,014)	-79.4%	-36713.0%
Net currency exchange gains (losses)	**412**	**4,093**	**844**	**(309,014)**	**-79.4%**	**-36713.0%**
Comisions and other client services	**97,003**	**85,550**	**115,452**	**113,128**	**35.0%**	**-2.0%**
Other revenues	888	2,074	49	68	-97.6%	38.8%
Total income	**109,556**	**98,129**	**108,014**	**(298,489)**	**10.1%**	**-376.3%**
Salaries and other employee benefits	(15,953)	(13,839)	(13,409)	(14,358)	-3.1%	7.1%
Depreciation and amortization	(8,468)	(7,869)	(8,341)	(8,278)	6.0%	-0.8%
Other expenses	(76,871)	(68,878)	(80,004)	(88,880)	16.2%	11.1%
Total expenses	**(101,292)**	**(90,586)**	**(101,754)**	**(111,516)**	**12.3%**	**9.6%**
Net profit (loss) before taxes	**8,264**	**7,543**	**6,260**	**(410,005)**	**-17.0%**	**-6649.6%**
Tax expense	(3,212)	(2,319)	(324)	107,545	-86.0%	-33292.9%
Net profit (loss)	**5,052**	**5,224**	**5,936**	**(302,460)**	**13.6%**	**-5195.4%**

CREDIVALORES CREDISERVICIOS S. A. RATIOS (%)	Dec-19	Dec-20	Dec-21	Dec-22
Return on assets (ROA) 12 months	0.2%	0.2%	0.2%	-11.2%
Return on equity (ROE) 12 months	1.8%	1.8%	2.1%	-299.2%
Interest income and similar / Total income	13.7%	3.0%	-8.5%	36.9%
Eficiency (Op. expenses / Op. income)	92.5%	92.3%	94.2%	-37.4%
Equity / Assets	13.3%	12.1%	9.2%	-2.2%
Liquid assets / Total assets	19.0%	21.3%	18.8%	14.7%
Liquid assets / Financial obligations	24.5%	27.0%	21.7%	14.9%

VI. TECHNICAL COMMITTEE MEMBERS:

The resumes of the members of the Technical Rating Committee are available on our website www.brc.com.co