FitchRatings

Fitch Downgrades Credivalores IDR to ‘B-‘; Outlook Negative

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Fitch Ratings has downgraded Credivalores-Crediservicios S.A.'s (Credivalores) Long-Term Foreign Currency Issuer Default Rating (IDR) to 'B-' from 'B' and the senior debt to 'B-'/'RR4' from 'B'/'RR4'. Fitch has maintained the 'B' Short-Term Foreign Currency IDR and assigned Long-Term Local Currency IDR at ‘B-‘and Short-Term Local Currency IDR at ‘B’. Negative Outlook.

Fitch has also downgraded Credivalores' Long- and Short-Term National Scale ratings to 'BBB-(col)'/'F3(col)' from 'A-(col)'/'F2(col)'. Fitch has downgraded the company's partial credit guarantee (PCG) local issuance national rating to ‘A(col)’ from 'AA(col)' keeping the 4 notches relativity above Credivalores' Long-Term National Scale rating.

KEY RATING DRIVERS

The downgrade reflects the materialization of Credivalores’ ratings sensitivity regarding pre-tax income to average assets due to the net losses suffered in 2022 and the material breach of the tangible leverage sensitivity, which reflects a very low loss absorption capacity and a structural deterioration. These metrics had been under pressure for the rating level for several years due to almost null profitability and high appetite for growth.

Although the company has announced a capital injection for USD55 million to restore its capital levels as well as a new funding structure that reduces pressures on the short term, the Negative Outlook reflects Fitch assessment that downside risk remains if the entity is not able to generate organic capital through sustainable earnings and business growth.

Challenging Operating Environment: Colombian non-bank financial institutions (NBFIs) continue to face multiple headwinds, including reduced investor and creditor confidence, tighter economic conditions, high and rising inflation, and weaker growth prospects for 2023. Funding and liquidity will continue to weigh on NBFIs’ growth and profitability, especially given investor risk aversion and more limited access to local debt markets.

Concentrated Business Model: Credivalores is the largest non-bank financial institution in Colombia engaged in consumer lending to the low-to-mid income population that is not served by traditional banks in small and mid-sized cities. The company has been able to generate relatively stable total operating income (TOI) in the last four years with an average of USD27 million from 2019 to 2022. However, the latest TOI was a negative USD45, driven by

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structural issues. As part of 2022 stress situation and limited investor confidence for Latam NBFI, Credivalores served 100% (aprox USD218 million) its financial commitments and found different funding alternatives including own resources, asset backed funding sources and shareholders credit.

Strategy Focus on Payrolls Loans: Fitch expects Credivalores announced strategies to focus on payrolls loans and the capital injection will help to overtake last year crisis. Changes on government structure also contribute with a strategy to achieve long-term sustainability of the entity, which still need to be proven. Credivalores management and strategy assessment is aligned with its business profile, remarking acceptable degree of depth, and experience and elevated key person risk, however a weak execution was exacerbated during the NBFI crisis presented in 2022. Credivalores capital injection include a new shareholder, a change in the shareholders structure and the appointment of a new CEO that will be defined in the coming months.

Higher Risk Profile: Credivalores has developed robust underwriting standards for the payroll business similar to other local competitors and following Colombian regulation for this segment. The niche target is characterized for a low risk profile (pensioners and government employees). However, high appetite for growth on unsecured loans underpinned weak asset quality, meanwhile refinancing risk boosted market risk exposures, reflecting poor stability of financial results throughout the cycle and weak risk controls.

Weak Asset Quality: Asset quality remains a challenge as the level of impaired loans (over 60 days) to total loans continued high at 19.7% at YE2022. The reserve coverage ratio decreased to 94% given the semi-secured portion of the portfolio, a level that compare below the average of the banking system of 240% at YE2022. The expected slowdown of the economy is likely to impact the metrics, mainly for the unsecured segment. NPLs will likely remain above 17% and asset quality will gradually improve once the company focus on payrolls start to gain weight on the loan portfolio.

Weak Profitability: The company reported significant losses in 2022 that magnified the historical weak internal capital generation. The pre-tax ROAA was -14.36% compare with its low average of 2018-2021 of 0.4%. A strong contraction on business volumes as a consequence of its 2022 payment of the financial commitments and higher funding cost undermined Credivalores' financial performance. Fitch expects the trend in profitability to change gradually in an 18 to 24 months period, supported on the payroll focus strategy and the use of asset backed founding sources. Short term profits should remain close to breakeven as operating environment and inflationary pressures, higher interest rates and slowing economic growth, will weigh on Credivalores' earnings generation.

Tight Capitalization and Leverage: Credivalores' high leverage remains the entity's main credit weakness due to almost null profitability and high appetite for growth. At year-end 2022 the company's capital and leverage metrics were impacted by negative profitability. As a result, the company's shareholders committed to capitalize for USD55 million to be received on May 2023 once complete local regulations approvals. Fitch expects that the new capital injection, a better debt maturity structure including long term bonds due in2025 and a gradual improvement on internal capital origination will improve leverage on the next 12 to 18 months, with a debt to tangible equity ratio around 10x at YE2023.

Improved Funding and Liquidity: During 2022 Credivalores' payment of around USD218 million including USD160 million 2022 bond maturity, implied a change in its funding structure to asset backed facilities, local issuances with partial guarantee from Fondo Nacional de Garantias, longer tenors and a better mix between local and foreign funding. Although debt maturity is now concentrated on 2025, Fitch expect part of the proceeds of the new capital injection along with different funding alternatives allowed a comfortable funding and liquidity structure commensurate with a rating level of b.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

--The inability of the entity to generate organic capital that leads to a tangible leverage, measured as debt/tangible equity, consistently above 15x and consistently low or null profitability not explained by a structural change in Credivalores business model, could pressure ratings downward.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Credivalores' ratings could be positively impacted if the company is able to show a sustained improvement in its profitability and asset quality metrics while reducing pressure on its tangible leverage metrics. A more consistent, conservative and demonstrated liquidity risk management track record could also contribute to future positive rating momentum.

DEBT AND OTHER INSTRUMENT RATINGS: KEY RATING DRIVERS

PCG Issuance

Credivalores partial guarantee bond local issuance for COP160.000 million is rated 4 notches above its national long term-rating. The level of enhancement above the base recovery correspond to the additional recovery that the guarantee gives to the notes which improves the recovery rate for the bond holders is case of default. The notes has an irrevocable partial guarantee for 70% for payment of interest or principal from Fondo Nacional de Garantias rated ‘AAA(col)’.

DEBT AND OTHER INSTRUMENT RATINGS: RATING SENSITIVITIES

--The company's senior unsecured debt is expected to move in line with the Long-Term IDR, although a material increase in the proportion of secured debt could result in the unsecured debt being notched down from the IDR.

PCG Issuance

--The four-notch relativity of the PCG issuance above Credivalores' Long-Term National Scale rating could be reduced in the event of future increases in the issuer rating or by an improvement in its intrinsic recovery, in accordance with the agency's methodology.

--A downward move in Credivalores' Long-Term National Scale rating would negatively affect the PCG ratings;

ADJUSTMENTS

Fitch has assigned a Business Profile score of 'b' that is below the 'bb' category implied score due to the following adjustment reasons: Business Model (negative) and Historical and Future developments (negative).

Fitch has assigned an Earning and Profitability score of 'b-' that is above the 'ccc' category implied score due to the following adjustment reasons: Historical and future metrics (positive).

Fitch has assigned a Capitalization and leverage score of 'b-' that is above the 'ccc' category implied score due to the following adjustment reasons: Historical and future metrics (positive).

Fitch has assigned a Funding, Liquidity and Coverage (Core 1) score of 'b' that is below the 'bb' category implied score due to the following adjustment reasons: Business model /funding market convention (negative).

Fitch has assigned a Funding, Liquidity and Coverage (Core 2) score of 'b' that is below the 'bb' category implied score due to the following adjustment reasons: Business model /funding market convention (negative).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY	RATING			RECOVERY	PRIOR
Credivalores-Crediservicios S.A.	LT IDR	B-	Downgrade		B
	ST IDR	B	Affirmed		B
	LC LT IDR	B-	New Rating		
	LC ST IDR	B	New Rating		
	Natl LT	BBB-(col)	Downgrade		A-(col)
	Natl ST	F3(col)	Downgrade		F2(col)
senior unsecured	LT	B-	Downgrade	RR4	B
guaranteed	Natl LT	A(col)	Downgrade		AA(col)

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Applicable Criteria

Exposure Draft: Non-Bank Financial Institutions Rating Criteria - Effective from 17 February 2023 to 5 May 2023 (pub.17-Feb-2023)(includes rating assumption sensitivity)
Metodología de Calificaciones en Escala Nacional (pub.22-Dec-2020)
Metodología de Calificación de Instituciones Financieras no Bancarias (pub.28-Mar-2022)
Metodología de Calificación de Soporte Parcial de Crédito por Terceras Partes (pub.26-Aug-2021)
National Scale Rating Criteria (pub.22-Dec-2020)
Third-Party Partial Credit Support Rating Criteria (pub.11-Jun-2021)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

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