Research Update:

Credivalores Outlook Revised To Negative On Weaker Operating Prospects Amid Economic Fallout, 'B/B' Ratings Affirmed

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Overview

- The Covid-19 pandemic and economic turndown in Colombia will weaken Credivalores' risk-adjusted capital (RAC) ratio and profitability, and raise its delinquencies levels during 2020.
- On the other hand, Credivalores enters the crisis with sufficient cash and financial flexibility to cover short-term wholesale funding and operational needs in the following 12 months.
- We're revising our outlook on Credivalores to negative from stable. At the same time, we're affirming our 'B/B' issuer credit and 'B' issue-level ratings on Colombia-based nonbank financial institution (NBFI) .
- The negative outlook reflects that Credivalores' creditworthiness is vulnerable to rapid deterioration of the economy, which could pressure the entity's payment collection and profitability in the following months.

Rating Action

On May 12, 2020, S&P Global Ratings revised its outlook on Credivalores - Crediservicios SAS to negative from stable. We also affirmed our 'B' long-term and 'B' short-term issuer credit ratings on the firm. At the same time, we affirmed our 'B' issue-level rating on the firm's senior unsecured notes.

Rationale

The outlook revision reflects our view that the pandemic induced economic crisis will erode Credivalores' operating performance. The firm's credit card portfolio is exposed to the rapidly deteriorating economy, which could widen credit losses beyond those of peers. We also expect pressures on the firm's bottom-line results, and consequently, on our projected RAC ratio for it, which will be around 5.5% for the next 12-24 months. These factors could undermine Credivalores' business stability and spike its delinquency levels, weakening its credit profile.

Finally, the ratings on Credivalores continue to reflect our business position assessment on it, which is supported by a diversified business mix and leading position in Colombia's NBFI segment. We also incorporate our view of the firm's improving but still concentrated funding structure, primarily consisting of two global issuances, and enough liquidity to meet its debt maturities and support growth in the following 12 months.

The anchor that starts our rating analysis of NBFIs is three notches below the anchor for banks in the same country. This is to reflect NBFIs' typical lack of access to central bank credit lines, lower regulatory oversight, and higher competitive risk than among banks. For NBFIs in Colombia, we apply the standard notching relative to the bank anchor of 'bb+'; so our starting point for rating Credivalores is 'b+', given that 100% of its loan portfolio exposure is in Colombia.

We revised our assessment on Credivalores' capital and earnings to moderate from adequate on weaker profitability prospects and internal capital generation. Our forecast of a RAC ratio of about 5.5% for the next 12 months incorporates the following assumptions:

- Colombia's GDP to contract 2.6% in 2020 and grow 4.1% in 2021;
- A loan growth portfolio of about 3% for 2020 considering the loan portfolio securitization, and 10% for 2021;
- Core earnings to average adjusted assets (ROAA) droping to -1% for 2020 and at about 0.18% for 2021;
- Efficiency levels at 59% for 2020 and improving to about 51.6% for 2021;
- No dividend payments or capital injections for the next two years;
- Nonperforming assets (NPAs) slightly around 15% with a reserve coverage around 80% of total NPAs.
- Net write-offs around 2% for the next couple of years.
- Securitization (true sale) of around COP100 billion that will limit the growth of risk-weighted assets (RWAs).

Although interests on loans will continue to accrue during forbearance periods, credit deterioration of loans will deplete the firm's net interest income. Credit losses will be inevitable, and loan-loss provisions will surge. As a result, we expect Credivalores to post net losses in 2020. On the other hand, the resizing of commercial and marketing costs, negotiation of lease payments, and the suspension of non-essential projects will reduce expenses could enable the firm to generate earnings once Colombia's economy starts to rebound. Finally, Credivalores' quality of capital is high, reflecting the absence of hybrid instruments in its capital structure and shareholders' track record of support in maintaining capital.

A diversified business mix and solid market position continues to support Credivalores' business position. Its strategy for 2020 is to cope with the COVID-19 and preserving cash, although its loan origination will take a hit from the economic downturn and restriction measures to reduce contagion. Credivalores has taken actions, including expanding its digital platform, to ensure business continuity and mitigate the impact the quarantine can have on its operations. Nevertheless, the firm's loan portfolio growth will decrease to 3% in 2020 from 9.5% in 2019. Credivalores will support its clients by allowing the deferral of payments for a couple of months. Management expects 60%-70% of its clients will apply for these grace periods. We expect the impact on the firm's credit card unit to be more pronounced than its payroll loan segment, which is more stable and less sensitive to economic uncertainty. Therefore, we expect payroll discount loans to represent 60%-65% of the total loan portfolio at of the end of 2020, while credit cards will account for 30%-35%, and insurance financing for the remainder. Despite adverse economic and industry conditions, we expect Credivalores to remain as one of the leading non-regulated consumer finance companies in Colombia, with about a 1.6% market share of the total Colombian payroll discount lending segment and 3.4% of the credit card business.

Weaker asset quality metrics than those of other NBFIs we rate in the region, coupled with its concentration within the consumer lending segment reflects our risk position assessment on Credivalores. Despite a recent drop in its delinquencies levels and credit losses, we expect asset quality metrics to slip amid worsening economy. The corrective measures such as the expansion of digital offerings, a quicker response to applications for credit, and adjustment in origination policies caused NPAs and charge-offs to decrease to 11% and 1.14%, respectively, as of December 2019 from 15.2% and 1.5% as of June 2019. In addition, loan-loss reserves covered 1.2x of NPAs at year-end. Nevertheless, we expect the firm's exposure to the low-income credit card users amid currently difficult market conditions will also take a toll on Credivalores' asset quality, despite the client diversification and credit forbearance measures. The granularity of the firm's loan exposure provides some diversification, but ultimately could prove less beneficial in current recession. Consequently, we project NPAs and net charge-offs to rise to levels similar to the 2019 peak of 15% and 2%, respectively, by year-end. In this sense, we believe Credivalores' credit quality will remain weaker than those of regional peers. We expect the NPA reserve coverage to be about 80% for the next two years.

In our view, Credivalores' liquidity is sufficient to fund daily operations thanks to the remaining proceeds from the recent market debt issuance that the firm used to prepay 47% of the outstanding senior unsecured notes maturing in 2022. Therefore, we believe it has sufficient cash flow and financial flexibility to cover short-term wholesale funding and operational needs in the following 12 months despite very difficult operating conditions. Credivalores signed an additional COP87 billion of available resources in its syndicated committed credit line. In this sense, with approximately $110 million in cash and about $34 million in committed credit lines, we believe Credivalores enters the crisis with adequate liquidity, as seen in a broad liquid assets to short-term wholesale ratio at 2.2x as of March 31, 2020. In addition, it benefits from financial flexibility given that secured funding accounts for only 14% of total, the firm can reduce credit originations, and a planned securitization in the second half of 2020 to relive liquidity pressures. In this sense, our base- and stress-case scenarios assume that Credivalores' cash flow analysis remains positive. On the other hand, if payment collections are below our expectation due to souring loans and if the market volatility continues to discourage investors from the securitization and the mutual fund market, Credivalores could face a liquidity crunch. This would prompt us to reassess our liquidity and funding assessment on the firm to weaker categories in the following months.

Our view of Credivalores' funding remains unchanged. The firm relies on a more concentrated funding structure than the NBFIs industry. Although the issuances improved the lender's debt maturity profile and kept stable funding ratio at slightly above 100%, we believe that Credivalores' funding structure will remain concentrated in market debt, reliant on investor confidence and less diversified than those of other finance companies that we rate regionally. The two international notes will continue to represent about 80% of the total funding base. The remainder of its funding base consists of credit facilities from banks, securitizations, trusts and shareholder's capital. Finally, we expect funding costs could decrease in tandem with the reference rates. However, spreads could widen for future funding if stringent market conditions persist.

Outlook

The negative outlook reflects our view that in the next 6-12 months, Credivalores will grapple with deteriorating operating conditions due to the economic crisis stemming from COVID-19.

Downside scenario

We could lower the ratings in the next 6-12 months if Credivalores' liquidity and cash flow analysis are strained due to a deeper reduction in collections beyond our base-case projections, or if it's unable to obtain liquidity by securitizing or selling loans. We could also lower the ratings in the next 12 months if Credivalores' loan portfolio quality erodes, reflecting the riskier credit card products' offset of the relative stable payroll loan portfolio. The latter would result in the NPAs plus NCOs ratio above 15% or if its RAC ratio drops below 5%.

Upside scenario

We could revise the outlook to stable on the ratings on Credivalores in the next 12 months if management's contingent measures slow the weakening of the NPAs plus NCOs ratio. Additionally, we could revise the outlook if profitability metrics improve and Credivalores keeps adequate market position and diversified business mix that allow for steady operating revenue.

Ratings Score Snapshot

Issuer Credit Rating B/Negative/B

SACP b

Anchor b+

Business Position Adequate (0)

Capital, Leverage, and Earnings Moderate (0)

Risk Position Moderate (-1)

Funding and Liquidity Moderate and Adequate (-1)

Support 0

GRE Support 0

Group Support 0

Government Support 0

Additional Factors +1

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Criteria | Financial Institutions | General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

	To	From
Credivalores-Crediservicios SAS		
Issuer Credit Rating	B/Negative/B	B/Stable/B
Senior Unsecured	B	