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Research Update:

Credivalores - Crediservicios SAS Outlook Revised To Negative On Weakened Capitalization, 'B+/B' Ratings Affirmed

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Overview

- Capitalization metrics of Colombian nonbank financial institution (NBFI), Credivalores, dropped due to the recognition of a minority equity exposure and the adoption of IFRS 9 in the first quarter of 2018. In our opinion, these effects could hamper the lender's ability to absorb unexpected losses.
- Additionally, we believe asset quality metrics continue deteriorating, pressuring our risk position assessment. We believe Colombia's sluggish economy had increased the financial system's and the firm's nonperforming assets (NPAs), especially in the latter's credit card unit.
- On the other hand, Credivalores remains as one of the largest player in its main business lines, and its debt maturity profile is comfortable for the next 12 months.
- We're revising our outlook on Credivalores to negative from stable. We're also affirming our 'B+/B' issuer credit and 'B+' issue-level ratings on the firm.
- The negative outlook for the next 6-12 months reflects a potential downgrade if Credivalores fails to implement its proposed measures to reinforce its capital base.

Rating Action

On Sept. 27, 2018, S&P Global Ratings revised its outlook on Credivalores - Crediservicios SAS (Credivalores) 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 negative outlook reflects the deterioration in Credivalores' risk-adjusted capital (RAC) ratio due to the impact of IFRS 9 adoption that decreased total adjusted capital (TAC), coupled with the recognition of a minority equity exposure that increased the firm's risk-weighted assets (RWAs) sharply. In our opinion, the lower RAC ratio could hamper Credivalores' ability to absorb unexpected losses. We could downgrade the lender if it fails to implement corrective measures to strengthen the capital base in the following months, leading to a RAC ratio of less than 7%. Additionally, the outlook revision reflects that the lender will maintain NPAs and net charge-offs just below 12% of the total portfolio.

The issuer credit ratings on Credivalores reflect a diversified business mix and good market position in the Colombian financial system. We also incorporate its lending and underwriting standards, which are moderately conservative in our opinion, compared with those of other NBFIs we rate in the region. In addition, the ratings reflect our view of the lender's concentrated funding structure, which consists of a single global issuance, and sufficient liquidity levels to support growth. The stand-alone credit profile (SACP) remains at 'b+'. which incorporate our positive view of Credivalores' credit profile compared with those of other NBFIs we rate in the region. We believe Credivalores has particular fundamentals that will allow it to navigate through Colombia's still lackluster economy, such as a high portion of payroll discount loans that account for 53.4% of its total credit loans. And we don't expect the rising unemployment rate to weaken the lender's portfolio, because 85.8% of its payroll clients are public-sector employees or retirees and about 47% of the total loan portfolio consists of loans to these borrowers.

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 the central bank's credit lines, lower regulatory oversight, and higher competitive risk than that for 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 all of its loan portfolio exposure is in Colombia.

In our view, Credivalores' business position benefits from a diversified business mix, a larger market position than those of other NBFIs in Colombia, gradually increasing operating revenue, and absence significant concentrations by clients, sector, or geography. Although Credivalores faces intense competition, it's one of the largest non-regulated consumer finance companies in Colombia, with about a 1.6% market share of the country's payroll discount lending segment and 3.2% of the credit card business, its two main business lines. The lender also offers an insurance financing product. We consider revenue sources are more diversified than those of Credivalores' immediate peers, and net interest income, fees, and commissions represent almost 100% of the total revenue. The latter, in our opinion, is less sensitive to market fluctuations. As of June 30, 2018, payroll discount loans represented around 55% of the lender's total portfolio, followed by credit cards (37%), and insurance financing (8%). In the short term, we expect Credivalores to focus on the payroll-lending segment, these types of loans perform best amid under economic downturns. However, the lender will continue operating the three business lines in the long run. In this sense, we don't expect new products or significant changes in core operations for the next 12 months.

Our capital, leverage, and earnings assessment on Credivalores reflects our projected RAC ratio around 7.2% for next 12-18 months. In addition, the lender has high quality of capital, in our view, reflecting the absence of hybrid instruments, along with improving profitability indicators. However, our new RAC forecast ratio is significantly lower than our projection in 2017 of 8.5%. The ratio dropped due to adoption of IFRS 9, including impairment expenses for COP47 billion, which were reflected in the shareholders' equity and an increase in net deferred tax assets (DTAs). The latter stemmed from the derivative valuations effects, which prompted the lender's TAC to drop. We also neutralized the variation in the OCI account of the shareholder's equity due to derivative valuations under IFRS 9. Finally, the recognition of a 9% stake in equity exposure in Asficredito, a company that manages the sales force of Credivalores, raised our calculation of RWAs, lowering the RAC ratio.

In our opinion, the management's target to strengthen the capital base in the fourth quarter of 2018, coupled with a slowly improving internal capital generation and the average loan portfolio growth of 11% for the next two years, will gradually increase our RAC ratio to about 7.2% for 2018 and 2019. However, if Credivalores fails to implement its capital measures or exhibits higher-than-expected growth in its RWAs --not covered by internal generation--we could downgrade the lender.

Our base-case scenario for our RAC forecast incorporates the following factors:

- Colombia's GDP growth of 2.6% for 2018 and 2.7% for 2019 (according to our last Credit Conditions Committee research published Sept. 27, 2018, "Weakening Investor Sentiment Will Test Latin America's Decision Makers");
- A loan growth portfolio of about 11% for 2018 and 2019;
- Debt capitalization of around COP3 billion in the third quarter of 2018 from Grammercy, one of Credivalores' shareholders;
- Full divestment of Asficrédito, leading to a significantly decrease in S&P's market risk RWAs;
- Additional measures to strengthen the capital base;
- Improving profitability with a core earnings to average adjusted assets (ROAA) around 1.1% during 2018 and 2019;
- Efficiency levels at 70% for 2018 and slightly improving to about 67% for 2019;
- NPAs slightly below 12% with a reserve coverage above 100%;
- Net write-offs below 1% for the next couple of years; and
- No dividend payments for the next two years.

We expect stronger profitability metrics than in 2017, because of currency mismatches and losses due to the unhedged position for its debt program that year. As of June 30, 2018, all of Credivalores' foreign currency debt is hedged to Colombian pesos through derivative instruments including non-delivery forwards, cross currency swaps, and options with international financial institutions. We expect the lender to fully hedge any additional foreign currency debt and to adjust the call spread exercise price, if necessary, to avoid additional losses in the future. The ratings could drop if the lender fails to do so.

Our risk position assessment on Credivalores reflects its fragmented loan portfolio, and moderately conservative lending and underwriting standards. However, its asset quality metrics mainly in the credit card unit continue weakening, pressuring the firm's risk position. As of June 30, 2018, Credivalores' NPAs were 10.8%, in addition to a COP22 billion portfolio write-off, which resulted from the impairment tests in the IFRS adoption. We believe the NPA ratio is getting closer for a negative adjustment if it continues increasing; however, we project the ratio to remain slightly below 12% for the next 12-18 months. On the other hand, reserve coverage had increased to 109% for the same timeframe, compared with 89% one year before. We expect reserve coverage to remain above 100% following the IFRS 9 implementation. During the next 12 months, we expect credit losses to remain below 1%.

Offsetting weak asset quality metrics is the absence of significant risk exposures by sector, country, or single name in the loan portfolio. As of June 30, 2018, top 20 clients represent less than 1% of total loans. Moreover, Credivalores operates through offices, points of sale, and mobile units in more than 40 cities/municipalities. Credivalores' geographical diversification is in line with those of other NBFIs we rate in the region.

Our funding assessment on Credivalores reflects it reliance on a more concentrated funding structure than the NBFI industry norm. Despite gaining significant financial flexibility by freeing a considerable amount of encumbered assets and increasing the average term of total debt to more than three years, in line with the average duration of its loan portfolio, Credivalores' funding structure will largely consist of a single issuance. We forecast that by the end of 2018, the 144A/Reg S notes will account for around 75% of Credivalores' total funding, while the remainder will come from other wholesale funding sources including as trusts, banking lines, and capital. After reducing its heavy dependence on secured debt, the lender's current challenge is to diversify its funding structure by gaining access to unsecured banking lines, or other means of funding, to reduce the funding concentration.

Our liquidity assessment is primarily based on our projected base case and stress-test cash flow, which will be positive for the next 12 months. Moreover, Credivalores' use of the proceeds from the notes issuance to refinance existing debt provided greater liquidity cushion for upcoming debt maturities. As a result, we estimate Credivalores' liquidity to remain sufficient, at least during the next 12 months and in line with that of other NBFIs we rate in the region. We don't expect significant debt amortizations or liquidity needs in the same time frame.

Outlook

The negative outlook, for the next 6-12 months reflects a one-in-three chance of a downgrade if Credivalores' RAC ratio doesn't rise above 7%. In addition, we expect the firm to maintain manageable NPAs and net charge-offs, and a concentrated funding structure.

Downside scenario

We could lower the ratings in the next 6-12 months if Credivalores fails to increase its capital and RAC ratio above 7%. A downgrade is also possible if NPAs and net charge-offs increase above 12% or if management fails to adjust its hedge on the COP75 billion add-on principal under a scenario of steep currency depreciation.

Upside scenario

We could revise the outlook to stable in the next 6-12 months if pressures on our capital assessment eases, allowing Credivalores to improve its RAC ratio consistently above 7%. The latter is possible through capital injections or improved internal capital generation while the lender maintains manageable asset quality metrics.

Ratings Score Snapshot

Issuer Credit Rating	B+/Negative/B
SACP	b+
Anchor	b+
Business Position	Adequate (0)
Capital, Leverage, and Earnings	Adequate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Moderate and Adequate (-1)
Support	0
GRE Support	0
Group Support	0
Government Support	0
Additional Factors	+1

Related Criteria

- 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
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- 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

Ratings Affirmed; Outlook Action

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.