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Research Update:

Credivalores - Crediservicios SAS Downgraded To 'B' From 'B+' On Asset Quality Deterioration; Outlook Is Stable

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria

Ratings List

Research Update:

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Overview

- Deterioration in its credit card business, coupled with operational issues in its payroll and insurance financing products, significantly worsened Credivalores - Crediservicios SAS' asset quality metrics. Although deterioration already peaked in December 2018, we expect the nonperforming assets (NPAs) plus net charge-offs (NCOs) ratio to be around 15% in the next 12-18 months.
- Shareholders and senior management have been supporting the firm's capitalization levels, reflected in a forecast risk-adjusted capital (RAC) ratio of 7%, on average, for the next 18 months. Nevertheless, internal capital generation remains low.
- We are lowering our long-term issuer credit rating and issue-level rating on the company's senior unsecured notes to 'B' from 'B+'.
- The stable outlook reflects our expectation that Credivalores will remain one of the largest market participants in its main business lines compared with other local nonbank financial institutions (NBFIs) while keeping adequate capitalization and below-average asset quality indicators.

Rating Action

On July 5, 2019, S&P Global Ratings lowered its long-term issuer credit and senior unsecured debt ratings on Colombia-based NBFIs Credivalores - Crediservicios SAS to 'B' from 'B+'. S&P Global Ratings also affirmed its 'B' short-term issuer credit rating on the company. Accordingly, we also lowered our stand-alone credit profile (SACP) on Credivalores to 'b' from 'b+'. The outlook is stable.

Rationale

We lowered the ratings on Credivalores following the deterioration of its risk position due to the significant increase in past due loans over the past few quarters. Although deterioration already peaked in December 2018, we expect the NPAs plus NCOs ratio to be about 15% in the next 12-18 months and still compare above that of its regional peers. In addition, coverage of NPAs by loan loss reserves fell below 100%. The company faced significant

deterioration in its credit card business coupled with specific operational problems in its payroll and insurance financing products. The latter weakened its risk profile and led to a spike in its delinquencies metrics. We believe the increased cost of risk could impair the company's performance in the next 12 months.

In our view, the company's NPAs plus NCOs and coverage metrics are no longer comparable with those of its peers in the adequate risk position category that we rate. Loan portfolio deterioration was mainly caused by the credit card business, reflecting Colombian economic imbalances over the past two years that also affected other Colombian institutions. However, the impact lagged in Credivalores due to its alliances with utility companies. In addition, some of the company's customers were affected by the influx of immigrants from Venezuela as well as the slowdown in the oil and gas sector. In addition, payroll loans and insurance financing product led to an increase in delinquencies due to some operational problems. As of March 2019, the firm's NPAs plus NCOs ratio was 15.5%, compared with 10.4% as of December 2017 and the 5.5% average of its regional peers. Moreover, the coverage of its nonperforming loans by loan loss reserves was 90% at the same date. Credivalores took several corrective actions that include adjustments in its origination policies, reduction in the time of response in credit originations, a new banking core, new chief risk officer, alliances with new utility companies, and a review of all the processes to reduce operational issues. Even though these measures have begun to bear fruit and stop this negative trend--mainly reflected in the most recent collections and vintage analysis, we believe that they will gradually take time to be reflected in healthier loan portfolio metrics that include charge-offs and delinquencies above 360 days.

On the other hand, management has taken measures to strengthen the company's capitalization metrics in line with the shareholders' commitment to support the company's growth. Therefore, despite the company's low profitability levels, our forecast RAC ratio for the next 18 months is 7%. The ratings on Credivalores also reflect our business position assessment supported by a diversified business mix and good market position in the Colombian financial services system. Finally, we incorporate our view of the company's improving but still-concentrated funding structure primarily in one global issuance and enough liquidity to meet its debt maturities and support expected growth.

The ratings also incorporate our overall view of Credivalores' credit profile compared with that of other NBFIs we rate in the region. We consider the firm's strategic commercial agreements, adequate capital, and shareholders' support positive features that suggest an additional notch of support to the SACP. Therefore, it stands at 'b'.

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 relative to banks. In the case of 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.

Credivalores' capital, leverage, and earnings assessment reflects our projected RAC ratio of about 7%, on average, for the next 18 months, coupled with high quality of capital--reflecting the absence of hybrid instruments--and management's and shareholders' commitment to support the company's capital metrics. The latter has been reflected by the measures taken since our last review that include the full divestment of the company's minority stake in Asficredito, a commercial auxiliary company that supported Credivalores' credit activities and a COP15 billion capital injection by its shareholders. The sale of the equity exposure significantly reduced the company's market risk-weighted assets (RWAs) and the capital injection supported the growth of its total adjusted capital that compensated modest net income and an increase in derivative counterparty exposures. We expect that Credivalores will continue implementing measures to maintain its current capital levels.

Our base-case scenario for the next 18 months considers the following assumptions:

- Colombia's GDP to increase 2.9% in 2019 and 3.0% in 2020 (according to "Credit Conditions Latin America: Optimism Fades Despite Fed's Pause," published June 27, 2019, on RatingsDirect);
- A loan growth portfolio of about 10% on average for 2019 and 2020
- Marginally improving profitability metrics with a core earnings to average adjusted assets ratio of about 1.3% on average during 2019 and 2020;
- Efficiency levels at 64% for 2019 and slightly improving to about 60% for 2020;
- No dividend payments for the next two years;
- NPAs of about 14% with reserve coverage of about 80% of total NPAs; and
- Net write-offs of about 2% for the next couple of years.

In our view, Credivalores' business position is supported by a diversified business mix, an above-average market position among NBFIs in Colombia, and increasing operating revenues. Despite facing intense competition, the firm is one of the leading non-regulated consumer finance companies in Colombia, with an almost 1.6% market share of the total Colombian payroll discount lending segment and 3.4% of the credit card business, its two main business lines. The latter is complemented by an insurance financing product and the recent incorporation of cell phone financing. We consider that revenue sources are well diversified compared with those of its peers, and net interest income and fees and commissions represent almost 100% of total revenues, which, in our opinion, are more stable and less sensitive to market fluctuations. As of March 31, 2019, payroll discount loans increased their share within the total loan portfolio and represented about 59% of total loans. This increase comes

as part of the company's efforts to stabilize asset quality issues as this product has significantly performed better historically. Credit cards represented about 35% of the total portfolio, followed by insurance financing with 6% for the same period. Finally, we forecast that the company's digital transformation will enhance its origination capabilities and business activity to support stable growth.

Although improving, Credivalores' funding still relies on a concentrated structure compared with the industry norm. We forecast that by the end of 2019, the 144A/Reg S notes will account for about 60% of Credivalores' total funding, while the remaining 40% will come from other wholesale funding sources such as trusts, banking lines, and capital. After reducing its significant dependence on secured debt, the company's challenge is to continue diversifying its funding structure from secured to unsecured banking lines, or other means of funding, to lessen its current concentration. On the other hand, the average life of debt of 2.8 years as of March 2019 and small short-term debt maturities place Credivalores in a good position to meet its financial obligations in the following 12 months. The company gained significant financial flexibility by freeing a considerable amount of encumbered assets with the international bond issuance. As well, the company has some committed credit lines to face adverse market events in Colombia. As a result, our projected base case and stress-test cash flow analysis are positive for the next 12 months.

Outlook

The stable outlook reflects our view that in the next 12 months, Credivalores will maintain a forecast RAC ratio of 7%, asset quality metrics such as NPAs plus NCOs above 12% of its total portfolio, and a concentrated funding structure. The stable outlook also incorporates our view of the company's good market position and diversified business mix.

Downside scenario

We could lower the ratings over the next 12 months if Credivalores shows further deterioration in its loan portfolio reflected in an NPAs plus NCOs ratio above 20%. We could also lower the ratings if the company's positive adjustment in its SACP is not supported by adequate capitalization, reflected in a RAC ratio consistently below 7%. This could happen if the cost of risk rises, affecting profitability and internal capital generation.

Upside scenario

We could raise the ratings on Credivalores in the next 12 months if management's corrective measures improve asset quality metrics quicker than we expect, reflected in an NPAs plus NCOs ratio consistently below 12%. We could also raise the ratings if the firm continues diversifying its funding sources by gaining access to unsecured banking lines, or other multiple sources of funding, to reduce its expected concentration.

Ratings Score Snapshot

Issuer Credit Rating	B/Stable/B
SACP	b
Anchor	b+
Business Position	Adequate (0)
Capital, Leverage, and Earnings	Adequate (0)
Risk Position	Moderate (-1)
Funding and Liquidity	Moderate and (-1) Adequate
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

Downgraded; CreditWatch/Outlook Action; Ratings Affirmed
 To From
 Credivalores - Crediservicios SAS

*Research Update: Credivalores - Crediservicios SAS Downgraded To 'B' From 'B+' On Asset Quality Deterioration;
Outlook Is Stable*

Issuer Credit Rating	B/Stable/B	B+/Negative/B
Senior Unsecured	B	B+

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