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Research Update:

Credivalores - Crediservicios SAS 'B+/B' Credit Ratings And 'B+' Issue-Level Rating Affirmed; Outlook Still Stable

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Overview

- Colombian nonbank financial institution (NBFI) Credivalores remains one of the largest market participants in its main business lines compared to other local NBFIs.
- However, the firm's funding structure will be significantly concentrated in a single issuance; riskier than the structures of its regional peers.
- Profitability metrics declined last year and have continued declining in the first half of 2017. Credivalores has stopped selling loans and was negatively impacted by the Colombia peso depreciating against the dollar. We expect profitability levels to gradually improve until 2019.
- We're affirming our 'B+/B' credit ratings on Credivalores. We're also affirming the 'B+' issue-level rating on the firm's senior unsecured notes.
- The stable outlook for the next 12 months reflects our view that Credivalores will maintain a risk-adjusted capital (RAC) ratio of 8.5%, manageable asset quality metrics with non-performing assets (NPAs) below 12% of the total portfolio, and a concentrated funding structure.

Rating Action

On Sept. 25, 2017, S&P Global Ratings affirmed its 'B+' long-term and 'B' short-term counterparty credit ratings on Credivalores - Crediservicios SAS (Credivalores). At the same time, we affirmed the 'B+' issue-level rating on the firm's senior unsecured notes. The outlook remains stable.

Rationale

The issuer credit ratings on Credivalores reflect our business position assessment, supported by a diversified business mix and good market position in the Colombian financial system; its capital and earnings, underpinned by our forecasted RAC ratio of 8.5%, on average for the next 12 to 18 months; and its risk position, mainly driven by its lending and underwriting standards that are stronger than those of other NBFIs we rate in the region. The ratings also reflect our view that the firm's funding structure is primarily concentrated in one global issuance, and that its liquidity levels are in line to support our expected growth. The stand-alone credit profile (SACP) remains 'b+'.

The ratings also incorporate our positive view of Credivalores' credit profile compared with other NBFIs we rate in the region. We believe Credivalores has fundamentals that will allow the company to navigate through the challenging Colombian economic conditions. In our view, for the next 12-18 months, the company's credit losses will be manageable, because payroll discount loans account for 53% of its total credit loans and we don't expect the unemployment rate to affect this portfolio, since 87% of its payroll clients are public employees or retirees.

The anchor that forms the basis for our rating analysis of NBFIs is three notches below the anchor for banks in Colombia. This reflects NBFIs' typical lack of access to central bank credit lines, lower regulatory oversight, and higher competitive risk relative to 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.

In our view, Credivalores's business position is supported by a diversified business mix, an above-average market position among the Colombian NBFIs, and positive and relatively stable operating revenue with no significant client, sector, or geographic concentrations. Additionally, we believe that Credivalores's management team has sound experience in the firm's main business lines and financial markets; and that the team is strategically competent and can produce organizational effectiveness. Although Credivalores faces intense competition, the firm is one of the largest non-regulated consumer finance companies in Colombia, with an almost 1.5% market share of the country's payroll discount lending segment and 2.6% of the credit card business; its two main business lines. The firm's business line revenue is also well-diversified compared with its immediate peers. As of June 30, 2017, payroll discount loans represented around 55% of total revenue, followed by credit cards at 35%, and insurance at 10%. Credivalores' revenue has been relatively less sensitive to market fluctuations than those of other regional NBFIs because of its less risky business products, especially payroll discount loans. Going forward, we expect the company to remain operating in its three business lines, as management will remain focused on its core business. Consequently, we don't anticipate changes to our business position assessment in the next 12 months.

Credivalores' capital, leverage, and earnings reflects our projected RAC ratio of around 8.5%, on average, for next 12 to 18 months, coupled with high quality capital--core capital is mainly composed of paid-in capital and retained profits--and improving profitability indicators. As of Dec. 31, 2016, Credivalores' RAC ratio was 7.3%; lower than our 8.4% in last year's forecast. The latter was driven primarily by lower than expected internal capital generation, because net income was 47% lower than last year's forecast. The firm stopped selling loans--which represented 13% of total revenues--because of the Colombian payroll crisis where some intermediaries were making fraudulent loans by selling the same loan to two or more different parties.

For the next two years, we forecast an average RAC ratio of 8.5%. In our

opinion, the firm's debt capitalization, improving internal capital generation, more modest growth loan portfolio (12.5%, on average, for the next two years), and lack of dividend payment will gradually increase our RAC ratio. Our base-case scenario for our RAC forecast is:

- Colombian GDP growth expectations at 1.7% for 2017 and 2.2% for 2018 (according to our last CCC published on June 30, 2017, "Political Uncertainty Hinders Improving Credit Conditions In Latin America");
- Debt capitalization of about COP53,511 billion during 2017;
- A loan growth portfolio averaging about 12.5% for 2017 and 2018;
- Lower profitability levels during 2017 and 2018 compared with 2016; with core earnings to adjusted assets hovering between 0%-1% for the next 18 months;
- Efficiency levels at 79% for 2017 and improving to about 70% for 2018;
- No dividend payments for the next two years;
- NPAs slightly below 12% with a reserve coverage around 90%; and
- No credit losses.

Profitability metrics declined during last year and continued to do so in the first half of 2017. As noted above, Credivalores stopped selling loans as they didn't want to be linked to intermediaries. However, the firm is working to increase their interest income and fees and commissions to recover the income lost from not selling loans.

During the first half of 2017, we saw negative bottom-line results driven by the Colombia peso's depreciation against the dollar. The company had unhedged debt--issued in the first half of the year--and had exchange rate (FX) exposure. Consequently, they had a FX loss of COP10,877 billion. We expect this to be a one-time loss, as Credivalores should cover all its exposure in the few next months and have positive net income by the second half of 2017. Nevertheless, we believe more stable profitability metrics until 2019.

Lending and underwriting standards better than other NBFIs we rate in the region, manageable but worsening asset quality metrics, and diversified risk exposures support Credivalores' risk position.

Asset quality remains manageable, but NPAs continue growing. Because the company does not charge-off loans (net charge-offs; NCOs), NPAs look higher than those of its main peers. As of June 30, 2017, Credivalores' NPAs were 11.6% and had averaged 10% for the past three fiscal years. We believe this ratio approaching a negative adjustment; however, we project NPAs to remain below 12% for the next 12 to 18 months. Reserve coverage reached 89.5% as of June 30, 2017, and the firm's strategy is to keep them at that level. During the next 12 months, we expect no credit losses and about 90% reserve coverage.

Counterbalancing its asset quality metrics, the firm doesn't have significant risk exposures by sector, country, or single-name in its loan portfolio. As of June 2017, its top 20 clients didn't represent a high percentage of total loans: they were less than 1% of total loans and only 0.03x of adjusted total equity (ATE). In geographic concentration, the company operates offices, sale points, and mobile units in more than 40 cities and municipalities. However,

three regions represent 50%--a slightly increase compared with 47% last year--of the total portfolio. Bogotá and Valle del Cauca are the largest regions. This geographic concentration is similar to other NBFIs we rate in the region.

Our funding assessment on Credivalores relies on a concentrated funding structure compared with the industry norm for NBFIs. Despite gaining significant financial flexibility by freeing a considerable amount of encumbered assets, Credivalores' funding structure remains significantly concentrated in one issuance. We forecast that by the end of 2017, the new notes will account for around 75% of Credivalores' total funding, while the remaining 25% will come from other wholesale funding sources such as trusts, banking lines, and capital. After reducing its dependence on secured debt, the company's challenge is to diversify its funding structure by gaining access to unsecured banking lines, or other means of funding, to reduce its expected concentration.

We base our liquidity assessment on our projected base case and stress-test cash flow, which will be positive for the next 12 months. Additionally, the use of the proceeds to refinance existing debt provides a greater liquidity cushion for upcoming debt maturities. As a result, we estimate that during the next 12 months, Credivalores' liquidity will remain sufficient and in line with that of other regional NBFIs we rate.

Outlook

The stable outlook for the next 12 months reflects our view that Credivalores will maintain a RAC ratio of 8.5%, manageable asset quality metrics--with NPAs below 12.5% of its total portfolio and similar reserve coverage--, 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' asset quality deteriorates beyond our projections or if we see a higher currency risk due to the issuance's hedge. The latter could decrease profitability indicators, adversely affecting the company's internal capital generation and decreasing our RAC ratio consistently below 7%. We could also lower the ratings if increasing asset quality pressures liquidity levels.

Upside scenario

We could raise the ratings in the next 12 months if Credivalores continues diversifying its funding sources by gaining access to unsecured banking lines, or other multiple sources of funding, to reduce its expected concentration. However, we believe this scenario is unlikely in the next 12 months.

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	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

Related Research

- Banking Industry Country Risk Assessment: Colombia, Sept. 14, 2017
- Political Uncertainty Hinders Improving Credit Conditions In Latin America , June 30, 2017
- Republic of Colombia Sovereign Credit Ratings Affirmed, Outlook Remains Negative, Jan. 18, 2017

Ratings List

Ratings Affirmed

Credivalores - Crediservicios SAS	
Counterparty Credit Rating	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.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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