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Research Update:

Credivalores 'B+/B' Ratings Affirmed On Adequate Risk-Adjusted Capitalization; Outlook Remains Stable

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Overview

- Colombia-based non-bank financial institution (NBFI) Credivalores has continued to improve its risk-adjusted (RAC) capital levels, reflected in a projected RAC ratio of 8.1% for the next 18 months.
- In contrast, the firm's funding sources are concentrated, with a high percentage of encumbered assets which, in our view, reduce Credivalores' financial flexibility.
- We affirming the 'B+' long-term and 'B' short-term issuer credit ratings on the firm.
- The stable outlook over the next 12 to 18 months reflects our expectation that Credivalores will maintain an RAC ratio of about 8.1%, manageable asset quality metrics, and a concentrated funding structure with relatively low financial flexibility.

Rating Action

On Nov. 4, 2015, Standard & Poor's Ratings Services affirmed its 'B+' long-term and 'B' short-term issuer credit ratings on Credivalores - Crediservicios SAS (Credivalores). The outlook remains stable.

Rationale

The issuer credit ratings on Credivalores reflect our assessment of its "adequate" business position (thanks to a diversified business mix and good market position), its "adequate" capital and earnings (mainly driven by our forecasted RAC ratio of 8.1%), and its "adequate" risk position (underpinned by its lending and underwriting standards, which are stronger than those of other NBFIs we rate in the region). The ratings also reflect our view of its "moderate" funding, underscored by a concentrated funding structure, and "adequate" liquidity. The stand-alone credit profile (SACP) remains 'b+'.

We initially set the anchor for NBFIs three notches below the anchor for banks in the same country to reflect the typical lack of access to central bank credit lines, lower regulatory oversight, and higher competitive risk relative to banks. We may modify that standard three-notch adjustment for NBFIs in countries or in sectors where these differences don't exist or are less pronounced (i.e., the finance company can access funding from the central

bank, are regulated to some degree, or have unique competitive positions, such as monopolistic or oligopolistic businesses).In the case of Colombia, we apply the standard three notches below the anchor.

In our view Credivalores' business position remains "adequate", reflecting a diversified business structure, a good market position in Colombia, stable and increasing operating revenues, and no drastic concentrations in terms of customer, segment, and geography. Moreover, we consider the firm's management team to have sound experience in its main business lines and a long track record in financial markets. Credivalores is a company dedicated to providing four business lines, placing the most emphasis on payroll discount loans and credit cards. In our opinion, as we have seen over the past several years, revenues are less sensitive to market perceptions of creditworthiness compared to other local and regional NBFIs due to their less-risky business products. Even though NBFIs continue to face intense competition, Credivalores has maintained growth above the market average and a diversified loan portfolio with no significant concentrations. However, it has no revenue concentrations that significantly impact its revenue sources, in consequence providing good revenue predictability. In addition, the company operates in more than 40 cities and municipalities. For the next 12 to 18 months, we do not expect relevant changes in our business position assessment because we believe management will maintain its strategic focus on its core business lines.

We consider capital, leverage, and earnings "adequate". We base our assessment primarily on our forecasted RAC ratio of 8.1% for the next 18 months. This ratio slightly increased from the 7.9% ratio in 2014, and reflects our loan portfolio growth expectations coupled with no dividend payments, which will enhance the firm's internal capital generation. Our financial forecasts incorporate our base-case scenario assumptions, which include:

- Colombia's expected GDP of 2.5% for 2015 and 3.0% 2016;
- Loan portfolio growth of about 20% in next two years;
- Net interest margins (NIMs) to total loans lower than previous years--slightly under 5%--reflecting higher funding costs due to the increasing trend in Colombia's policy interest rate;
- Nonperforming assets (NPAs) to total loans slightly above 7% with reserve coverage above 100%;
- No charge offs;
- Return on average assets (ROAA) levels hovering between 1.3% and 1.8%, reflecting our credit growth expectations;
- Efficiency levels above 60%, as seen historically; and
- No dividend payouts.

Profitability metrics have remained relatively stable but below that of NBFIs with the within the same economic risk category. However, in Colombia, interest rates on consumer loans are capped, which limits profitability and constrains NIMs. As of June 2015, core earnings represented 1.3% of the company's ROAA, with an average for the past three fiscal years of 1.5%. During the next two years, we forecast that the ROAA will be--on average--between 1.3% and 1.8%, due to our credit portfolio growth

expectations and projected NIMs slightly below 5%. Its earnings have remained positive and relatively stable, even amid market distress.

Our assessment of its "adequate" risk position is mainly underscored by the firm's lending and underwriting standards (which are more conservative than other NBFIs we rate in the region), diversified risk exposures, and asset quality metrics that are in line with other NBFIs we rate. The firm does not have significant risk exposures by sector or single name concentrations in the loan portfolio. Its top 20 clients represent about 0.58% of total loans and 0.4x of adjusted total equity. Both ratios have remained consistent with previous years and we expect them to remain so, thereby underpinning a pulverized risk profile.

On the other hand, the firm's asset quality has remained manageable and reserve coverage has been improving during 2015. As of June 2015, NPAs were 7.2%, with a three-year average of 8%. In addition, NPAs reserve coverage stood at 100%, representing an improvement from 80% a year earlier. During the next 12 to 18 months, we believe NPAs will hover around 7.0%-7.5%, slightly lower than in 2014; we project no credit losses and at least 100% reserve coverage of NPAs.

Our "moderate" funding assessment reflects the firm's concentrated funding structure. Almost all of its funding relies on banking lines through various vehicles. Its funding structure is as follows: portfolio sales, 40%, trusts, 32%, banking lines, 15% and market debt, 13%. These funding sources require collateral to provide credit lines, but provide better maturity and interest rate gaps. Nevertheless, in our view, these highly encumbered assets--although they have declined over the past two years--reduce the firm's financial flexibility and could hamper its funding needs in the event of market fluctuations. During the next 18 months, we expect that funding sources will be slightly diversified because we expect a gradual increase in market debt (the company has been able to further tap into this funding source over the past 12 months, while gradually increasing its tenures). We also expect that it will have fewer encumbered assets. Nevertheless, we believe its concentrated funding structure will remain in place, providing less stability during stress scenarios (compared to other NBFIs we rate). In this regard, we don't anticipate changes in our funding assessment over the next 12 months.

Credivalores' liquidity assessment remains "adequate", supported by our forecasted base-case and stress-test cash flow, which will remain positive for the next 12 months. The firm's debt structure, which is mainly composed of long-term maturities, benefits Credivalores' liquidity since it doesn't have significant short-term liquidity needs. In this regard, for the next 12 to 18 months, we do not expect unusual liquidity needs that could jeopardize the firm's liquidity position and core operations.

Outlook

The stable outlook over the next 12 to 18 months reflects our expectation that Credivalores will maintain an RAC ratio of about 8.1%, manageable asset quality metrics, and a concentrated funding structure with relatively low financial flexibility. The outlook also incorporates its "adequate" business position, reflected in a good market position and diversified business mix.

Downside scenario

We could lower the ratings over the next 12 to 18 months if Credivalores' low financial flexibility drastically pressures the company's liquidity or if the firm's asset quality deteriorates significantly. The latter could occur if the company enters unknown markets or riskier segments of the economy, relaxing its underwriting standards in pursuit of credit growth, which could yield NPAs well above its main competitors (more than 10% NPAs, plus credit losses). A rise in NPAs could also increase loan loss provisions and thus affect internal capital generation. In that case, our projected RAC ratio could stand consistently below 7% and could also trigger a negative rating action.

Upside scenario

We could raise the ratings in the next 12 to 18 months if the firm continues to diversify its funding and gains financial flexibility by reducing the amount of unencumbered assets that it could pledge for additional funding sources. We could also raise the ratings if we see an important enhancement in the firm's business position, reflected in more diversified business lines and an improved market position.

Ratings Score Snapshot

Issuer Credit Rating	B+/Stable/B
SACP	b+
Anchor	bb-
Business Position	Adequate (0)
Capital 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	0

Related Criteria And Research

Related Criteria

- Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- Group Rating Methodology, Nov. 19, 2013
- Quantitative Metrics for Rating Banks Globally: Methodology and Assumptions, July 17, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology and Assumptions, Dec. 6, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Credit Conditions: Latin America Buffeted By Winds From China And Brazil, Oct. 15, 2015
- Most Finance Companies Are Ripe For Growth Amid Choppy Global Economy, Sept. 29, 2015

Ratings List

Ratings Affirmed

Credivalores - Crediservicios SAS
Counterparty Credit Rating B+/Stable/B

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 Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

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