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Research Update:

Colombia-Based Credivalores 'B+/B' Ratings Affirmed On Resilient Financial Performance; Outlook Remains Stable

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Overview

- Colombian nonbank financial institution (NBFI), Credivalores, remains a large market participant in its main business lines compared with other domestic NBFIs.
- However, in our view Credivalores continues to show limited financial flexibility, given the low proportion of unencumbered assets for pledging against potential additional funding, although this has improved over the past 24 months.
- We are affirming our 'B+/B' credit ratings on Credivalores.
- The stable outlook reflects our expectation that Credivalores will maintain a risk-adjusted capital ratio of 8.2%, on average, for the next 12 months, even with higher risk-weighted assets stemming from increased economic risk in Colombia.

Rating Action

On Oct. 4, 2016, S&P Global Ratings affirmed its 'B+' long-term and 'B' short-term counterparty credit ratings on Colombia-based nonbank financial institution Credivalores - Crediservicios SAS (Credivalores). The outlook remains stable.

Rationale

The ratings continue to reflect our assessment of Credivalores' adequate business position, which is underscored by a diversified business mix and good market position; its adequate capital and earnings, underpinned by our forecast risk-adjusted ratio (RAC) ratio of 8.2%, on average, for the next 12 to 18 months; and its adequate risk position, mainly driven by its lending and underwriting standards, which are stronger than those of other NBFIs we rate in the region. The ratings are constrained by our view of the company's moderate funding, with a concentrated funding structure and lower financial flexibility than other NBFIs we rate in Latin America, and only adequate liquidity. The stand-alone credit profile (SACP) remains at 'b+'.

The ratings also incorporate our positive view of Credivalores' credit profile compared with other NBFIs we rate in the region. We believe Credivalores' credit fundamentals will allow it to navigate through the slowing Colombian economy. In our view, the company's credit losses will likely be manageable

for the next 12-18 months because payroll discount loans account for 57% of its total loans, and we don't expect the unemployment rate to affect this portfolio, since more than 80% of its payroll clients are public employees or retirees.

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.

We regard Credivalores' business position as adequate because of its good market position compared with that of other Colombian NBFIs; its diversified portfolio, which has three main business lines (payroll, 57% of total loans; credit cards 35%; and insurance financing 7.5%); and a steady revenue base that has been increasing over the past few years. Furthermore, we believe Credivalores' corporate governance is adequate and its management team has long-standing experience and a good track record in the industry. Even though NBFIs continue to face intense competition, Credivalores is one of the largest non-regulated consumer finance companies in Colombia, with almost 2% of the country's payroll discount lending market. Also, it has maintained above-average growth, with no important revenue concentration that could hamper its operations. In our view, as we have seen over the past several years, Credivalores' revenues are less sensitive to market fluctuations than those of other local and regional NBFIs, due to its less-risky business products, especially payroll discount loans. For the next 18 months, we expect it will continue with similar business operations because management will remain focused on its core competencies. Therefore, we anticipate no changes to our current business position assessment in the next 12 months.

Credivalores' capital, leverage, and earnings remain adequate, in our view. As of Dec. 31, 2015, our RAC ratio for the company was 8.5%, but since then, in our view, economic risk in Colombia has increased (see "Brazil's Weak Economy And Global Volatility Are Clouding Latin America's Credit Outlook," published July 8, 2016, on RatingsDirect). Given the resulting higher risk weights, Credivalores' RAC ratio would now be 7.6% because all of its exposure is in Colombia. Nevertheless, we believe that loan portfolio growth, which we project at 30% over the next two years, coupled with good internal capital generation and no dividend payment, will gradually strengthen the RAC ratio to around 8.2%, on average, for the next 18 months.

In our base-case scenario, we assume for our RAC ratio forecast:

- Colombian GDP growth of about 2.3% in 2016 and 3.0% in 2017 (see "Brazil's Weak Economy And Global Volatility Are Clouding Latin America's Credit Outlook," published July 8, 2016);
- Loan portfolio growth of about 30% for 2016 and 2017;
- A net interest margin (NIM) of 13%, on average, for the next two years;
- Profitability at similar levels as in 2015, with core earnings to

adjusted assets at 2%-3% for the next 18 months;
- Efficiency levels at about 75% for 2016 and 2017;
- No dividend payments for the next two years;
- Nonperforming assets (NPAs) representing about 8.5% of total loans, with reserve coverage higher than 90%; and
- No credit losses.

Although Credivalores' profitability has remained relatively stable, it is below the average of other rated NBFIs that operate in countries with similar economic risk as Colombia. However, interest rates on consumer loans in Colombia are capped, which limits profitability and constrain NIMs. As of June 30, 2016, core earnings represent 2.0% of the company's average assets and the average for the past three fiscal years was slightly higher, at 2.8%. The average for NBFIs we rate in Latin America is above 3.5%. Over the next 12 months, we forecast Credivalores' core earnings at 2%-3%, reflecting our growth projections, the company's funding capacity, and its similar business operations.

Credivalores' risk position is adequate, supported by lending and underwriting standards that we regard as sound compared with that of other NBFIs we rate in the region, manageable asset quality metrics, and diverse risk exposures. Asset quality remains at manageable levels, and we expect similar figures for the next 12 months. The company does not charge off loans, so NPAs appear higher than those of its main peers. As of June 30, 2016, Credivalores' NPAs were 8.9% of total loans and the average for the past three fiscal years was similar, at 8.7%. In our view, Credivalores' NPAs plus credit losses compare adequately with those of other companies we rate that are also focused on similar business lines. The company's loss reserve coverage has been increasing, reaching 87% at the end of second-quarter 2016, and its strategy is to achieve and maintain 100% coverage. During the next 12 months, we project NPAs at 8%-9%, similar to the 2015 levels, no credit losses, and at least 90% reserve coverage.

The company does not have significant risk exposures by sector, country, or single names in the loan portfolio. As of June 30, 2016, the 20 largest exposures were negligible: less than 1% of total loans and only 3.4% of total adjusted capital. Regarding geographic concentration, the company operates in more than 40 cities/municipalities, with three representing around 47% of the portfolio, which is similar to that of other NBFIs we rate.

Our moderate funding assessment continues to reflect Credivalores' below-average funding structure compared with that of other NBFIs we rate in Latin America. In our view, Credivalores' funding is concentrated and almost fully dependent on banking lines through various vehicles. These funding sources require collateral, but they also provide a fairly good match between maturity and interest rates. As of June 30, 2016, 50% of the funding mix comprised trusts (through which the company gets collateralized funding), 19% portfolio sales, 19% capital market debt, and the rest correspond to banking lines. That said, the firm has made efforts to reduce the high amount of encumbered assets (by decreasing overcollateralization levels) as well as its

funding costs. Nevertheless, we continue to believe that this type of funding mix could limit the firm's financial flexibility and, during market turmoil, erode its funding profile. During the next two years, we expect the company will continue diversifying the funding structure and that, as a result, its encumbered assets will decrease.

Our assessment about its liquidity remains adequate. The latter is primarily driven by our projected base case and stress-test cash flow, which will be positive for the next 12 months. Moreover, the firm does not have significant short-term liquidity needs that could jeopardize its daily operations. As a consequence, we estimate that, during the next 12 months, liquidity will remain adequate and in line with that of other NBFIs we rate in the region.

Outlook

The stable outlook reflects our expectation that Credivalores will maintain a RAC ratio of 8.2%, on average, for the next 12 months, even with higher risk-weighted assets stemming from increased economic risk in Colombia. We also expect Credivalores will display manageable asset quality indicators and a concentrated funding structure with limited financial flexibility. The stable outlook also incorporates our view of the company's adequate business position, reflected in a good market position and diversified business mix.

Downside scenario

We could lower the ratings over the next 12 months if Credivalores' liquidity were to come under significant pressure due to weaker financial flexibility or a sharp deterioration of asset quality indicators. The latter could occur if the company enters riskier segments or unknown markets, or if it relaxed its underwriting standards to pursue credit growth. This could increase the company's NPAs well above those of its main competitors, by more than 10% (measured as NPAs plus credit losses), or lead to higher loan loss provisions, thereby adversely affecting internal capital generation. As a consequence, our projected RAC ratio could fall below 7% and trigger a negative rating action.

Upside scenario

We could raise the ratings in the next 12 months if Credivalores were to continue diversifying its funding sources and gain additional financial flexibility, including through increasing the amount of unencumbered assets for use against potential additional funding.

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 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
Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
Use Of CreditWatch And Outlooks, Sept. 14, 2009
Bank Capital Methodology and Assumptions, Dec. 6, 2010
Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
Commercial Paper I: Banks, March 23, 2004

Related Research

- Banking Industry Country Risk Assessment: Colombia, Aug. 31, 2016
- Brazil's Weak Economy And Global Volatility Are Clouding Latin America's Credit Outlook, July 8, 2016
- Republic of Colombia Outlook Revised To Negative On External Weakness;'BBB/A-2' Foreign Currency Ratings Affirmed, Feb. 16, 2016

Ratings List

Ratings Affirmed

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