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Research Update:

BAC International Bank 'BBB-/A-3' Ratings Affirmed On Continuing Profitable Operations And Sound Business Position

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Research Update:

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Overview

- Panama-based universal bank, BAC International Bank Inc., continues to show resilient operating performance with profitable operations.
- We are affirming our 'BBB-' long-term and 'A-3' short-term issuer credit ratings on the bank and its core subsidiary, Credomatic.
- We expect the bank to keep its sound and leading business position in Central America, with very profitable operations, while operating in higher risk economies.

Rating Action

On Aug. 25, 2014, Standard & Poor's Ratings Services affirmed its 'BBB-' long-term and 'A-3' short-term issuer credit ratings on BAC International Bank Inc. (BIB) and its core subsidiary, British Virgin Island-based Credomatic International Corp. (Credomatic). The outlook on both entities remains stable.

Rationale

The issuer credit ratings (ICR) on BIB currently reflect our "strong" assessment for its business position due to its leading market share in Central America, our view of "moderate" capital and earnings, "adequate" risk position thanks to sound underwriting and low credit losses, and our view of its "average" funding and "adequate" liquidity. The bank's stand-alone credit profile (SACP) remains at 'bbb-'.

We currently rate the bank above Costa Rica's sovereign rating (BB/Stable/B) primarily because BIB has passed the stress test we apply to banks in order to be rated above countries that represent more than 25% of their credit exposure. We expect Costa Rica will represent about 25% of BIB's loan exposures for the next two years. We conclude that the bank's sound business diversification provides sufficient capital and liquidity cushion to protect BIB in the hypothetical event of Costa Rica's default.

The 'bb+' anchor draws on our Banking Industry Country Risk Assessment (BICRA) methodology and our view of the weighted average economic risk in the countries in which BIB has exposure through its loan book--Panama (30%), Costa Rica (20%), Guatemala (20%), El Salvador (10%), Honduras (10%), and Nicaragua (10%) at year-end 2013. These country exposures already incorporate the recent acquisitions the bank went through during 2013. As a result, the weighted economic risk is about '7'. A BICRA is scored on a scale from 1 to 10, ranging from the lowest-risk banking systems (group '1') to the highest-risk (group '10'). The common factor driving this economic risk score is low income in the countries where the bank operates, which affects the country's vulnerability to external shocks, and debt and payment capacity in countries with weak rule of law.

The industry risk for Panama, where the bank is domiciled, is '5'. We see a gradual improvement in Panama's regulatory framework, as it has strengthened its provisioning rules and it has made tangible efforts to improve its capitalization framework and converge to Basel II rule, though Basel III implementation is still far away. There is still room for improvement, and we believe that the regulatory developments will continue. The absence of a lender of last resort or a formal support framework remains an important concern, and we expect it will limit our overall industry risk assessment for the next two years. This is somewhat mitigated by the consistent development of domestic capital markets, which are currently an adequate alternative for most financial institutions.

We continue to view BIB's business position as "strong." Our opinion continues to reflect the bank's leading position in Central America within the consumer segment (particularly credit cards), as well as a conservative and adequate management focused on executing a comprehensive corporate strategy. BIB is one of the largest banks in Central America with operations in every country in that region. Although its market share relative to each country is only adequate, it's 9.2% of the total region's market share in terms of total loans as of March 2014. We consider this leading position has allowed BIB to have strong business stability, despite operating in higher risk economies. The recent acquisitions of Guatemala-based Banco Reformador S.A. (not rated) and Panama-based Banco BAC Panama S.A. (formerly BBVA Panama; BBB-/Stable/A-3) have further enhanced its already sound regional presence.

Strong revenue stability has relied on a good revenue structure. Thanks to its credit card business, fee income accounts for slightly more than 31% of the bank's total revenues, and we expect this to remain so in the future. We expect BIB to continue leveraging on its sound brand recognition and strong presence in Central America, which in our view, should continue to provide it with a healthy revenue stream and expanding customer base. We believe these factors will not change for the next two years and still compare favorably with other banks we rate that have exposure to Central American economies. We also expect BIB to maintain its strategy of long-term growth thanks to its successful products platform and network, and specialized knowledge of the region and product expertise, which results in high entry barriers.

Our assessment about BIB's capital and earnings remains "moderate." This assessment continues to be based on our forecast RAC ratio, which we project will be about 6% for the next 12-18 months. This forecast RAC ratio takes into account the following base-case scenario assumptions:

- Panama GDP growth of 6.1% in 2014 and 6.3% in 2015;

- The other Central American economies expand as follows:
- Guatemala: 3.4% in 2014 and 2015;
- Honduras: 3.0% in 2014 and 2015;
- El Salvador: 2.3% in 2014 and 2.5% in 2015; and
- Costa Rica 3.9% in 2014 and 4.2% in 2015;
- BIB's loan portfolio growth of 15% in 2014 and 17% in 2015, which incorporate the bank's acquisitions during second half of 2013;
- Lower dividend payouts than those in the previous two years;
- Efficiency ratio at 57%-58% for the next two years;
- No additional acquisitions for 2014 and 2015; and
- Overall risk-weighted assets before diversification grow 15.1% in 2014 and 16.2% in 2015.

BIB continues to generate strong earnings, which has resulted in a profitable banking operation for the past several years. The main profitability metrics continue to compare well with those of other large regional players within the same industry risk score. The bank's core earnings to average adjusted assets were about 2.5% for the past four years, and we expect them to be at about 2.3% for the next 12-18 months. Supporting also our strong view of quality of earnings is the adequate efficiency ratio (measured as operating expenses to operating revenues), which has been about 57% for the past 18 months, and the low share of both trading gains and other revenues in the mix, historically at about 8%. We forecast that profitability will remain strong due to sound revenue stream and good efficiency.

Our opinion about BIB's "adequate" risk position reflects its adequate asset quality characterized by low credit losses, despite the higher risk economies in which the bank operates. In our view, the bank achieved the latter through prudent underwriting standards, deep risk knowledge of the different country markets, and sound risk diversification. As of March 2014, its loan portfolio consisted of commercial (37%), mortgages (24%), credit card (24%), auto (7%), and personal loans (7%). Loan portfolio composition hasn't significantly changed during the last two years, and we expect it to remain so for the next 12-18 months. In addition, BIB's top 20 largest exposures represented only 8% of the bank's total loan portfolio and only 49% of its capital base. The latter reflects a high retail focus in its credit operations, keeping its loan portfolio relatively pulverized. However, we believe that its exposure to higher risk economies somewhat limit our current risk position assessment. Asset quality has remained unchanged. Both nonperforming assets (NPAs) and credit losses (measured as net charge-offs) have averaged 1.7% and 1.2%, respectively, for the past three years. We estimate NPAs to remain at about 2% and credit losses to remain at less than 1.5% for the next two years.

We continue to view funding as "average" when compared to the industry norm. Customer deposits accounted for 77% of the total funding base as of June 2014. A large share of retail deposits, which in our opinion are more stable than wholesale funding, has also resulted in adequate stable funding ratios (SFR). As of June 2014, BIB's SFR was 117.3% with a three-year average of 114.0%. Also, the bank has managed different currency exposures in its deposit base, limiting them by funding local operations with local currencies. We don't expect changes in BIB's funding structure, with SFR at about 110%.

We consider its liquidity has remained "adequate" due to broad liquid assets that covered 2.7x its short-term wholesale funding at second-quarter 2014 with a three-year average of 2.5x. This stems from bank's lack of significant short-term maturities, its stable deposit base, and liquidity management that's based on the bank's prudent liquidity policies to cope with the diverse countries in which it operates. Although its liquidity coverage ratios are higher than those of other banks with operations in Central America (and higher than other banks across Latin America), most of its securities holdings are largely composed of securities that trade in the local and undeveloped capital markets that couldn't provide timely liquidity. In addition, we believe a liquidity cushion is necessary due to the lack of a lender of last resort in Panama. As we expect no changes in its liquidity management, we foresee broad liquid assets to remain more than 2.0x.

We continue to view BIB, and in turn Credomatic, as core entities for its ultimate parent, Colombia-based universal bank Banco de Bogota S.A. y Subsidiarias (Banco de Bogota; BBB-/Stable/A-3). Among other things, BIB operates in the same business lines as its parent and is closely linked to Banco de Bogotá's reputation and risk management. BIB keeps its performance in line with the group's expectation. At the end of 2013, BIB (on a consolidated basis including Credomatic) accounted for 28.1% of Banco de Bogota's total reported equity, 30.5% of total loans, and 26.6% of total operating revenues.

Outlook

The stable outlook on BIB and Credomatic continues to reflect its sound and leading business position in Central America, as well as the very profitable operations while operating in higher risk economies. The outlook also reflects that of Banco de Bogota as a result of BIB's and Credomatic's status as "core" subsidiaries.

A downgrade is highly unlikely, in our view, since we expect both entities' current core status to Banco de Bogota to remain the same in the future. BIB, on a consolidated basis, continues to account for a great portion of its parent's earnings and capital, and the group continues to view it a cornerstone for its future strategy. In this regard, the rating on BIB and Credomatic will move in tandem with those of the parent, as long as BIB continues to pass our sovereign stress test.

Ratings Score Snapshot

Issuer Credit Rating	BBB-/Stable/A-3
SACP	bbb-
Anchor	bb+

Business Position	Strong (+1)
Capital and Earnings	Moderate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	0
GRE Support	0
Group Support	0
Government Support	0
Additional Factors	0

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Ratings Above the Sovereign – Corporate and Government Ratings: Methodology and Assumptions, Nov. 19, 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

Related Research

- Colombian Banks' Regional Expansion Has So Far Come At The Expense Of Capitalization, July 7, 2014
- For Banks Globally, Higher Capital Requirements And Moderate Returns On Equity Will Constrain Lending Growth, June 11, 2014
- Credit Conditions: Credit Conditions In Latin America Are Stable, But Risks Remain, June 10, 2014
- Sluggish Economic Activity Is Weighing On Latin American Banks' Performance, June 5, 2014
- Despite Market Uncertainties, Latin American Banks Have Generally Been Able To Maintain Satisfactory Performance, Jan. 16, 2014
- Latin American Banks Lean On Adequate Funding And Liquidity Amid Market Uncertainties, Oct. 16, 2013

Ratings List

Ratings Affirmed

BAC International Bank Inc.	
Credomatic International Corp.	
Counterparty Credit Rating	BBB-/Stable/A-3

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.