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## Research Update:

# BAC International Bank Inc. 'BBB-/A-3' Ratings Affirmed On Continuing Leading Market Position In The Region

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## Overview

- Panama-based universal bank BAC International Bank Inc. has maintained its lead position as the largest financial institution in Central America on a consolidated basis.
- 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 solid market position in Central America, while maintaining its adequate asset quality metrics and current profitability levels.
- The stable outlook reflects that on the parent, Colombia-based universal bank Banco de Bogota S.A. y Subsidiarias (BBogota; BBB-/Stable/A-3) as a result of their status as core entities.

## Rating Action

On Aug. 31, 2015, 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 Islands-based Credomatic Inernational Corp. (Credomatic). The outlook on both entities remains stable.

## Rationale

Our ratings on BIB currently reflect: our "strong" business position assessment, as it is the largest financial institution in Central America on a consolidated basis; our view of its "moderate" capital and earnings; its "adequate" risk position, supported by its healthy and stable quality metrics and by its adequately diversified loan portfolio; and our view of its "average" funding and "adequate" liquidity. The bank's SACP remains 'bbb-'.

The issuer credit rating on BIB remains above the ratings on Costa Rica (BB/Stable/B), where it does a notable portion of its business (about 25% of its total loan portfolio) Under our sovereign stress test, we forecast that the  business diversification in terms of geography provides sufficient capital base and liquidity sources to support day-to-day operations in the hypothetical event of Costa Rica's default. This allows us to rate BIB above Costa Rica (please refer to Ratings above the Sovereign – Corporate and

Government Ratings: Methodology and Assumptions, published Nov. 19, 2013 on RatingsDirect).

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 (25%), Costa Rica (27%), Guatemala (18%), El Salvador (11%), Honduras (11%), and Nicaragua (8%) at year-end 2014. These country exposures already incorporate the recent acquisitions the bank went through during 2013 and 2014. 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.

Our industry risk assessment recognizes that Panama's regulatory framework lags behind some international standards, but the regulator's adequate track record and the banks' competitive dynamics provide stability to the financial system.

Nevertheless, our industry risk assessment remains limited by the absence of a lender of last resort in the country. Although the government offered liquidity support to all banks in 2008, we are uncertain about the timeliness and efficiency of this type of support in the event of an adverse economic or liquidity scenario. Our assessment also incorporates the long history of low loan loss ratios and Panama-based banks' high profitability.

Our opinion of BIB's "strong" business position continues to reflect the bank's leading position in Central America within the consumer segment, mainly through credit cards, which boosts its business stability and supports its well-diversified business activities. We believe the bank's leading position has allowed it to achieve a profitable scale while maintaining strong business stability and a clearly positive trend in its earnings. In fact, BIB represented 31% of its parent's operating revenues as of year-end 2014, adding stability to BBogota in terms of revenues. Because of this, we believe BIB is a fundamental tool for BBogota's business strategy. BIB has a market share of 9.3% in terms of total loans, and 7.9% in terms of deposits on a consolidated basis in Central America as of March 2015. Its total loan portfolio has expanded at a compound annual growth rate (CAGR) of 24.3% over the past three years, taking into account its recent acquisitions. We believe that these acquisitions have further enhanced its regional presence and have added more geographic and business diversification by giving it a footprint in Guatemala--the largest economy in Central America--and Panama, the fastest growing economy in the region. Going forward, we expect BIB's loan portfolio to grow about 17% during 2015 and 2016, with a relatively stable business composition. In terms of revenue stability, total revenues had a CAGR of 15.4% in the last three fiscal years. We expect BIB to continue to be the leading issuer of credit cards, leveraging its band recognition and strong presence in

Central America, which, in our view, should continue to provide a healthy revenue stream and growing customer base.

Its current corporate strategy aims to promote growth in its deposits base and to offer more banking products in retail banking. It also plans to target large corporations in commercial banking and to continue leading the credit card segment, with a large consumer client base as a result of its connection to BBogota. We believe that the bank successfully expanded in Central America with the recent acquisitions, since the bank maintained its adequate profitability and healthy asset quality metrics in the process, reflecting its specialized knowledge of the region and product expertise. We do not expect changes in BIB's market shares and revenue stability during the next two years. We believe the bank will remain well-positioned with respect to other rated banks with exposure to Central American economies.

We continue to base our assessment of BIB's "moderate" capital and earnings on our forecasted RAC ratio, which we believe will hover at about 6% over the next 12 to 18 months. Our forecasted RAC ratio takes into account the following base-case scenario assumptions:

- Panama GDP growth of 6% in 2015 and 2016 (according to our last sovereign risk indicators, June 30, 2015);
- The remaining Central American economies will expand as follows: Guatemala: 3.6% in 2015 and 3.5% in 2016; Honduras: 3.4% in 2015 and 3.4% in 2016; El Salvador: 2.5% in 2015 and 2.6% in 2016; Costa Rica 3.4% in 2015 and 3.5% in 2016;
- BIB's loan portfolio will grow by 17% in 2015 and 2016, as we expect current credit expansion will help BIB to maintain the current pace of growth and we believe BIB will consolidate its recent acquisitions during the next two years.
- Efficiency ratio of about 57.5% over the next two years, in line with its historical levels;
- Non-performing assets (NPAs) and credit losses will remain stable at 1.5%-2% and less than 1.5%, respectively, over the next two years;
- A $15 million dividend payment in 2015; and
- No additional acquisitions during 2015 and 2016.

We believe BIB has a strong quality of earnings, based on the soundness, resilience, and diversify of revenues. Its main metrics continue to compare well with other large regional players with the same industry risk score. As of June 2015, core earnings to average adjusted assets stood at about 1.75%, and has hovered around 2.20% over the past three years. We expect this ratio to be at about 2% over the next 12 to 18 months. The bank's adequate cost-income ratio, which has been around 58% over the past 3 years, supports the bank's quality of earnings, as does its low share of both trading gains and other income (historically around 8%). We expect its quality of capital and earnings to remain strong over the next 12 to 18 months, reflecting our expectations for strong growth and solid maintenance of good underwriting and cost policies.

BIB's continued growth and diversification, alongside adequate and stable asset quality metrics underpin our view of its "adequate" risk position. The bank has not experienced major disruptions while expanding operations in its targeted markets. Despite recent acquisition in Guatemala and Panama, management has been able to manage its growth and risk exposures, keeping asset quality and credit losses at adequate levels; BIB already had presence in Guatemala and Panama, so it is expanding into economies in which it already has knowledge and experience that offer good growth possibilities.

Risk diversification is sound compared to other rated banks with same risk position assessment. It commercial and corporate portfolio does not show concentration in terms of single exposures or economic segment. As of May 2015, its loan portfolio was composed of commercial (43%), mortgages (22%), credit card (20%), auto (6%) and personal and other consumer loans (10%). We are not expecting its loan portfolio composition to change significantly during the next two years. In terms of loan portfolio concentration by client, its top 20 largest exposures represent only 8% of the total loan portfolio and only 66% of its total adjusted capital (TAC). The latter reflects a high focus on retail in its credit operations, keeping its loan portfolio relatively pulverized.

Credit loss experience has remained stable because of  its historically adequate loan origination policies and its satisfactory expansion strategy. Both nonperforming assets (NPAs) and credit losses have averaged 1.5% and 1.2%, respectively, for the past three years and we estimate NPAs to remain between 1.5% and 2%, and credit losses to remain at less than 1.5% over the next two years. In this regard, we do not expect its credit risk management to weaken in the future, and we believe it will continue to be an anchor for strong credit loss experience.

We continue to base our assessment of its "average" funding  on its large deposit base and adequate funding metrics. As of June 2015, the stable funding ratio (SFR) for BIB was 117% with a three year average of 114%. The bulk of its funding base is customer deposits, accounting for 78% of which about 35% is made up of retail deposits, which are more stable; these figures compared adequately with other banks in the region. In terms of funding concentration, as of May 2015, its top 20 deposits represent only 10% of its total deposit base. We anticipate no changes in BIB's funding structure given that we expect growth in its deposit base to continue to provide it with the necessary resources to continue growing, with a healthy SFR hovering around 110%.

We base our assessment of its "adequate" liquidity on the bank's prudent liquidity policies, which enable it to cope with the diverse countries in which it operates and its manageable short-term obligations. We believe that refinancing risk is manageable, reflecting a historically adequate maturity profile. As of June 2015, its liquidity ratio (measured by broad liquid assets to short-term wholesale funding) stood at 3.4x with a three year average of 2.7x. Although its liquidity coverage ratios are higher than other banking systems' in Central America (and higher than other banks across Latin America), we view the bank's liquidity as "adequate". Most of its securities holdings are composed largely of securities that trade in the local and undeveloped capital market, where there is the absence of a deep and developed secondary market that could provide liquidity, which constrains its liquidity score. Our assessment is partially a result of the lack of a lender of last resort in Panama. We do not anticipate significant liquidity needs in the next 12 months, and the banks' large deposit base supports its funding and liquidity needs.

We continue to view BIB, and in turn Credomatic, as core entities to its ultimate parent, BBogota. Among other things, BIB operates in the same business lines as its parent, helping its parent to diversify its operations throughout Central America. BIB has kept its performance in line with the group's expectations. As of the end of 2014, BIB (on a consolidated basis, including Credomatic) accounted for 35% of Banco de Bogota's total reported equity, 39% of total loans, and 31% of total operating revenues.

## Outlook

The stable outlook on BIB and its subsidiary Credomatic continue to reflect its stable and leading business position in Central America as the largest player in the region in terms of total assets, as well as the very profitable operations it maintained while operating in riskier economies. The outlook also reflects that on the parent, BBogota, as a result of their status as core entities.

A ratings downgrade is highly unlikely, in our view, since we expect BIB and Credomatic to maintain their core status to BBogota 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 ratings on BIB and Credomatic will move in tandem with those on the parent. Additionally, given bank's high loan and income diversification, we expect BIB to continuing to pass our sovereign stress test in order to maintain its rating above the sovereign rating on Costa Rica. However, if there is deterioration in the sovereign rating on Costa Rica, the ratings on BIB could also weaken.

## 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

## 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.