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Research Update:

Banco Agromercantil de Guatemala 'BB/B' Ratings Affirmed; Outlook Remains Stable

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Overview

- Guatemala-based bank, BAM, maintained an adequate risk-adjusted capital ratio in 2014, even though its loan portfolio grew at a much higher pace than its capital base, as it deployed the resources from the capital injection in 2013 and from the senior notes issuance.
- We are affirming our ratings on the bank, including our long-term 'BB' and short-term 'B' issuer credit ratings.
- The stable outlook reflects our expectation that the bank will maintain its current adequate RAC ratio, as a result of internal capital generation that's consistent with the loan growth, and that it will maintain an adequate asset quality performance.

Rating Action

On Feb. 27, 2015, Standard & Poor's Ratings Services affirmed its long-term 'BB' and short-term 'B' issuer credit ratings (ICRs) on Banco Agromercantil de Guatemala S.A. (BAM). The outlook remains stable. At the same time, we affirmed our 'BB' issue-level rating to Intertrust SPV (Cayman) Ltd.'s $300 million senior notes due April 10, 2019. Intertrust SPV acts as trustee of the Agromercantil Senior Trust. BAM fully guarantees the notes, so the rating on the notes is the same as the long-term ICR on the bank.

Rationale

The ratings on BAM reflect its "adequate" business position thanks to satisfactory business stability and stable market shares, "adequate" capital and earnings due to a forecasted risk-adjusted capital (RAC) ratio of 7.6% for the next two years, "moderate" risk position that reflects the bank's above-average dollar-denominated loan portfolio, "average" funding, and "adequate" liquidity. The bank's stand-alone credit profile (SACP) is 'bb'.

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an ICR. The anchor for a bank operating only in Guatemala is 'bb+'.

In our view, economic risk in Guatemala has not changed since our January 2014 report. Our economic risk score for Guatemala reflects the country's limited fiscal flexibility, stemming from a low tax base that constrains the government expenditures in key areas, such as infrastructure and law enforcement (to stem the rising drug-related organized crime). Poor economic performance has prevented incomes from rising while continuing to limit private-sector debt capacity. This, along with significant foreign currency lending, results in very high credit risks in the economy. We believe risks from economic imbalances in Guatemala are "low." The country's real estate market is underdeveloped. Despite recent double-digit lending growth, the potential for a credit-fueled bubble is limited because credit to GDP has only risen 1.7 basis points in the past four years, and we don't expect this ratio to dramatically increase . On the other hand, the recent spike in foreign currency lending could become a concern if it maintains its current trend.

Our industry risk assessment for Guatemala incorporates the country's weak regulatory track record despite recent amendments to banking law to strengthen the regulatory framework and the scope of supervision. The "competitive dynamics" risks remain moderate thanks to the banking sector's sound profitability, with focus on simple banking products, and absence of significant market distortions. The large dollarization of the system continues to pose a risk. Guatemala's banking system has a historically stable core customer deposit base and access to multilateral external credit lines, but the small domestic capital debt market still prevents funding diversification.

Our assessment of BAM's business position is "adequate," reflecting its stable market share in the Guatemalan banking system, its revenue stability and its growth strategy. Despite the 27% loan growth in 2014, BAM maintained its position as the fourth-largest bank in Guatemala, with a market share of 10.7% and 8.3% in terms of loans and deposits, respectively. BAM's loan portfolio remains concentrated in corporate loans (80%), but we expect a further expansion of retail loans through cross-selling strategies. The bank has historically maintained stable operating revenues, which have grown at a compound annual growth rate of 10% in the past four fiscal years. In addition, BAM generates 85% of its revenues from net interest income, which support business stability. In the next few quarters, we expect the bank to gradually increase its position in the banking system due to its partnership with Bancolombia, S. A. y Companias Subordinadas (BBB-/Stable/A-3) and its rising share in syndicated loans.

BAM's capital and earnings are "adequate" based on our forecasted RAC ratio. The bank's internal capital generation didn't compensate for aggressive loan portfolio expansion in 2014, due to a capital injection in 2013 and the issuance of $300 million in senior notes. As a result, our projected RAC ratio is 7.6% for the next two years. Nonetheless, this ratio remains in the adequate category. Our base-case scenario incorporates the following assumptions:

- Guatemala's expected GDP growth of about 3.6% for the next two years;
- BAM's loan growth more in line with that of the banking system, about 8% for the next two years;
- Slight improvement in net interest margin (NIM) to 5.7% from 5.5% in 2014

as the bank expands its consumer loan portfolio and originates more loans in Guatemalan GTQ, which have a better spread;
- Loan loss provisions should consume about 10% of operating revenues amid stable asset quality performance;
- Nonperforming assets (NPAs) to be about 2% of the total loan portfolio and charge-offs to remain below 1%;
- Efficiency levels should continue to improving toward 60%; and
- Core earnings to average adjusted assets should be about 1.2% in the next two years.

Quality of capital and earnings are adequate. BAM has preferred shares in its capital structure for an outstanding amount of GTQ174 million at the end of 2014, representing only 8% of the bank's adjusted common equity (ACE). The bank can convert the preferred shares into common stock at any time. On the other hand, revenue mix remains healthy, net interest income accounts for the majority of revenues, and the bank is not engaged in trading activities from proprietary positions. As of December 2014, the bank reported a core earnings to adjusted assets ratio of 1.1%, slightly below the average of 1.2% for the past three fiscal years, but which we consider adequate for its financial risk profile.

Our assessment of BAM's risk position is "moderate" due to its aggressive loan portfolio growth in the past few years, the dollarization of its balance sheet, and adequate asset quality performance. As of December 2014, BAM's loan portfolio expanded 27% compared with 9% for the system, but we expect the pace for the next two years to be more moderate. The bank's asset quality is in line with the rest of industry, with NPAs of 1.67% as of December 2014 compared with the system's 1.29%. The bank maintains full reserves coverage, while its charge offs are below 1%. Given the bank's participation in syndicated loans with Bancolombia, Banistmo and Banco Agrícola in 2014, the proportion of dollar-denominated loans increased to 50% in 2014 from 40% in 2013, higher than the industry average, which isn't reflected in our current BICRA score for Guatemala. A portion of the bank's total loans is granted to domestic currency revenue generators, and in our opinion, this mismatch represents a risk under a stress scenario.

In our view, BAM's funding remains "average" compared to the banking industry. Customer deposits account for 77% of its funding base at the end of 2014, down from 85% in 2013 due to the senior notes issuance in the second quarter of 2014. The deposit base is highly fragmented because most of the bank's deposits come from retail clients, which in our opinion, provide more stability than institutional deposits do. Top 20 depositors represented nearly 12% of the total deposit base at the end of 2014, which we consider to be in line with those of other banks in the region. BAM's stable funding ratio was 120.7% as of December 2014, in line with the 117.5% average of the past three fiscal years. We don't expect significant changes in the bank's funding mix in 2015, and we expect the bank to fund new originations with deposits.

Our assessment of "adequate" liquidity is based on the bank's prudent liquidity management and satisfactory ratios. The bank is not exposed to significant refinancing risks in the short term because its funding structure consists mainly of deposits. Despite a higher cost of funds, the senior notes issuance allowed the bank to improve its maturity profile. At the end of 2014, broad liquid assets covered its short-term wholesale funding debt by 4.1x, given that its securities portfolio mainly consists of government securities, while bank lines represent only 7% of BAM's funding mix. Despite higher liquidity coverage ratios than those of other banks in Latin America, we view BAM's liquidity only as "adequate" because most of its securities trade in the domestic and undeveloped capital market, limiting its liquidity.

In our opinion, BAM has a "moderate" systemic importance for the Guatemalan financial system because it's the fourth-largest bank in terms of loans and deposits. We consider the Guatemalan government as being "supportive" towards its financial system. As a result, we believe there is a "moderate" likelihood of extraordinary government support, but currently the ratings on BAM are at the same level as its SACP, and the combination of both factors would not result in any notching uplift over the bank's SACP even if we were to raise the sovereign local currency rating.

Outlook

Outlook
The stable outlook on BAM reflects our expectation that it will maintain a RAC ratio of 7.6% in the next two years because its internal capital generation should compensate the growth in its loan portfolio. It also reflects our expectation that the bank will maintain adequate asset quality performance and its current market position in the Guatemalan banking system.

Downside scenario

We could downgrade BAM if its earnings generation can't fund its loan portfolio growth, lowering its RAC ratio below 7%. We could also downgrade the bank if its NPAs or charge-offs start to deteriorate consistently as a result of weak underwriting practices or the entry into riskier segments. Given that its ratings are at the same level as those of the sovereign, which constraint the ones on BAM as a result of its exposure to Guatemala, we will also lower the ratings on BAM if we were to downgrade the sovereign.

Upside scenario

On the other hand, we could upgrade BAM if we revise our risk position assessment to "adequate" as a result of the bank's lower dollarization level than the industry average. But such improvement will need to be accompanied with a sovereign upgrade. Given our "moderate" systemic importance assessment of BAM, if we were to raise the sovereign local currency rating, those on BAM would remain at their current level.

Ratings Score Snapshot

Issuer Credit Rating	BB/Stable/B
SACP	bb
Anchor	bb+
Business Position	Adequate (0)
Capital and Earnings	Adequate (0)
Risk Position	Moderate (-1)
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
- 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

- Banking Industry Country Risk Assessment: Guatemala, Jan. 15, 2015
- For Banks Globally, Higher Capital Requirements And Moderate Returns On Equity Will Constrain Lending Growth, June 11, 2014
- Supplementary Analysis: Republic of Guatemala, Dec. 30, 2014

Ratings List

Ratings Affirmed

Banco Agromercantil de Guatemala S.A.	
Counterparty Credit Rating	BB/Stable/B
Intertrust SPV (Cayman) Ltd.	
$300 million senior notes due 2019	BB

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.