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**Research Update:**

## **Banco Agromercantil de Guatemala S.A. 'BB-/B' Ratings Affirmed; Outlook Remains Stable**

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## Overview

- The slowing momentum in the Guatemalan banking system reflects the economic downturn and political instability, tamping down BAM's lending growth.
- Additionally, the bank's asset quality metrics slightly weakened, particularly in the retail lending segment, however, we still consider the decline as manageable for the bank.
- We're affirming our 'BB-' long- and 'B' short-term ratings on BAM and the 'BB-' issue-level ratings on Intertrust SPV's \$300 million senior notes, which BAM guarantees.
- The stable outlook on BAM reflects that on the sovereign, and our expectation that the bank's subsidiary status remains unchanged.

## Rating Action

On Nov. 9, 2017, S&P Global Ratings affirmed its 'BB-' long- and 'B' short-term global scale issuer credit ratings (ICRs) on Banco Agromercantil de Guatemala, S.A. (BAM). At the same time, we affirmed our 'BB-' issue-level rating on 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 them is the same as the long-term ICR on the bank. The outlook remains stable.

## Rationale

We continue view BAM as a core subsidiary for Grupo Bancolombia because the bank operates in business lines integral to the overall group strategy and its business risk is similar to that of Bancolombia. Therefore, we don't consider that the bank will be sold. Additionally, we expect BAM to be fully integrated into the group in the intermediate term and that the bank will represent a stable source of income through dividend payments. The 'BB-/B' foreign currency ratings on Guatemala limit the ICRs on BAM.

The stand-alone credit profile (SACP) on BAM continues to reflect its large market share, particularly in the corporate lending segment. The ratings incorporate our projected risk-adjusted capital (RAC) ratio of 5.5% on average for the next two years including a lending growth of around 3.8% in 2017. We still consider the high share of dollar-denominated loans in the portfolio as a significant vulnerability for the bank if the Guatemalan quetzal weakens against the dollar. On the other hand, despite the uncertain economic

conditions that's slowing the deposit growth, the bank's deposit-based funding is one of its main strengths that also provide enough liquidity to face short-term obligations.

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 issuer credit rating. The anchor for banks operating in Guatemala is 'bb' (please see "Three Guatemalan Banks Downgraded To 'BB-' From 'BB' On Similar Action On Sovereign, BICRA Revised To Group '7' From '6'," published Oct. 19, 2017, on Global Credit Portal).

Despite the lending portfolio contraction in 2016, BAM maintains its large market share thanks to its corporate loans that have helped the bank to maintain its operating revenue stability during the past few years. BAM has the fourth-largest market share in terms of total assets, loans, and deposits: 8.1%, 10.6%, and 7.5% respectively. Despite no growth as of June 2017, the bank's operating revenue has been stable in previous years due to BAM's large share of the system's corporate loans, which allowed the bank to maintain its business volume. BAM still faces tough competition in most of the lending segments that has required it to adjust its margins. On the other hand, management continues to increase the bank's participation in the retail lending segment with different various products such as payroll through the introduction of new channels like online banking services. However, we believe that it will take some time to see a more balanced revenue mix for BAM. Although we don't expect significant changes in the bank's business model for the next 12 months, with its integration with Bancolombia S.A. y Companias Subordinadas (Bancolombia; BBB-/Negative/A-3) we expect BAM's gradual expansion into other lending segments that will raise its market share. BAM posted a modest revenue growth in 2016 compared with previous years, therefore, the bank's internal capital generation has been sufficient to compensate for the dividend payments. Thus, we forecast our RAC ratio to be around 5.5% for 2017 and 2018. Our base-case scenario incorporates the following assumptions:

- Guatemala's GDP growth of 3.6% and 3.3% in 2017 and 2018, respectively;
- Loan portfolio growth of only 3.8% in 2017 and 6.0% in 2018;
- Nonperforming assets (NPAs) and net charge-offs (NCOs) will be around 3.0% and 0.8%, respectively, for the next two years;
- Efficiency level near 61% in 2017 and 2018;
- Net interest margin (NIM) to slightly increase to 4.88% at the end of 2017 due to the likely retail portfolio recovery;
- An estimated dividend payout of up to 60% of net income; and
- No capital injections in 2017.

In our view, BAM's quality of capital has remained sound due to high-quality capital base that consists of paid-in capital, reserves, and retained earnings. On the other hand, the bank's profitability slight weakened as of June 2017 due to lower interest income and higher non-interest expenses compared with those for the same period last year. Thus, as of June of 2017, core earnings to adjusted assets was 0.9%, and we expect to remain at similar level at the end of 2017.

In our opinion, the high dollarization of BAM's balance sheet and the still high customer concentration are the main vulnerabilities. However, the incentives to reduce dollar-denominated lending portfolio and higher interest rates in banking services in local currency have helped the bank to trim its share of the dollar-denominated loans to 45% as of June of 2017 from 48% in the same period last year. Although, the quetzal-dollar exchange rate has remained stable during the past few years, we consider that a potential depreciation of Guatemala's currency could jeopardize the bank's financial performance. The share of dollar-denominated loans in BAM's portfolio is higher than 39% for the banking system, which our BICRA for Guatemala already captures. Moreover, the bank is exposed to customer concentration (including related parties): as of June of 2017, its top 20 exposures represented 30.7% of the loan portfolio and 3.2x of the bank's total adjusted capital. The slowing economy weakened BAM's asset quality metrics, given that its NPAs increased to 3.3% as of June of 2017, which was higher than the industry average of 2.7% mainly due to the increase in foreclosed assets. Based on the bank's corporate lending orientation, a significant reduction of dollar-denominated loans is uncertain; however, we expect to see a rising share of retail loans in local currency for the next two years.

BAM's core deposits are its main source of funding because they represent more than 77% of the bank's funding structure as of June 2017. Also, BAM's deposit base is fragmented because more than 70% of it comes from the retail sector, which in our opinion, is one of the most stable sources of funding. The remainder of the funding structure mostly consists of inter-bank loans from domestic and international banks. Despite the bank's corporate lending orientation, BAM's top 20 depositors only represent 10% of the total deposit base, which we consider as in line with those of regional banks. Additionally, BAM will receive funding support from Bancolombia's subsidiaries to improve pricing conditions. On the other hand, BAM's stable funding ratio was 109.7%, which was lower than the 112.7% average for the past three years, but we still consider it sufficient to cover the bank's funding needs. Although BAM receives funding from the group, we believe that deposits will remain the bank's main source of funding, supported by additional initiatives to increase its deposit base. The bank's stable funding ratio will remain above 100% during the next 12 months.

BAM's wide range of funding sources and liquid assets--mainly consisting of cash and government securities--enables the bank to cover its liquidity needs because BAM doesn't have significant refinancing risks. As of June 2017, BAM's broad liquid asset to short-term wholesale funding was 2.6%, which is slightly lower than the past-three year average, but it's still in line with those of direct peers. For the next 12 months, we don't expect significant changes in BAM's liquidity given that the bank maintains a prudent liquidity management.

## Outlook

The stable outlook on BAM reflects that on the sovereign and our view that the bank will remain a core subsidiary to Bancolombia.

### Upside scenario

We could raise the ratings on the bank if we upgrade Guatemala, and our view on the support from Bancolombia toward BAM remains unchanged.

### Downside scenario

We can lower the ratings on the bank if we downgrade Guatemala. Other conditions that could result in a downgrade are more remote because a combination of factors would need to materialize, including a deterioration of the bank's capitalization resulting from weakening asset quality and profitability or driven by excessive growth; along with a significant change in our view of the level of group support to BAM.

## Ratings Score Snapshot

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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	+3
Government Support	0
Additional Factors	-3

## Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## **Ratings List**

### Ratings Affirmed

Banco Agromercantil de Guatemala S.A.

Counterparty Credit Rating

BB-/Stable/B

Intertrust SPV (Cayman) Ltd.

Senior unsecured \*

BB-

\*Guaranteed by Banco Agromercantil de Guatemala S.A.

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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