

**Credit Opinion: Banco de los Trabajadores**

Global Credit Research - 07 Mar 2014

Guatemala City, Guatemala

**Ratings**

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Ba3/NP
Bank Financial Strength	E+
Baseline Credit Assessment	b1
Adjusted Baseline Credit Assessment	b1
<b>Bantrab Senior Trust</b>	
Outlook	Stable
Bkd Senior Unsecured	Ba3

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**Key Indicators**

**Banco de los Trabajadores (Consolidated Financials)[1]**

	[2]12-13	[2]12-12	[2]12-11	[2]12-10	[2]12-09	Avg.
Total Assets (GTQ million)	12,562.4	9,623.8	8,178.2	6,646.4	5,706.1	[3]21.8
Total Assets (USD million)	1,601.8	1,217.7	1,046.5	831.3	684.7	[3]23.7
Tangible Common Equity (GTQ million)	1,015.6	764.0	699.0	662.3	633.0	[3]12.5
Tangible Common Equity (USD million)	129.5	96.7	89.4	82.8	76.0	[3]14.3
Net Interest Margin (%)	9.1	9.8	9.9	11.1	11.7	[4]10.3
PPI / Average RWA (%)	6.2	4.2	4.8	5.3	4.9	[5]5.1
Net Income / Average RWA (%)	3.5	1.7	2.0	2.3	2.5	[5]2.4
(Market Funds - Liquid Assets) / Total Assets (%)	-30.9	-33.0	-33.7	-27.4	-17.8	[4]-28.5
Core Deposits / Average Gross Loans (%)	156.1	160.5	159.0	143.0	134.7	[4]150.7
Tier 1 Ratio (%)	11.3	7.1	7.8	9.6	9.4	[5]9.0
Tangible Common Equity / RWA (%)	14.3	8.9	9.7	11.9	11.7	[5]11.3
Cost / Income Ratio (%)	65.3	65.1	61.0	59.1	63.5	[4]62.8
Problem Loans / Gross Loans (%)	1.4	2.4	2.8	4.8	8.4	[4]4.0
Problem Loans / (Equity + Loan Loss Reserves) (%)	7.7	13.0	14.5	24.1	43.0	[4]20.5

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel I; LOCAL GAAP [3] Compound Annual Growth Rate based on LOCAL GAAP reporting periods [4] LOCAL GAAP reporting periods have been used for average calculation [5] Basel I & LOCAL GAAP reporting periods have been used for average calculation

**Opinion**

## **SUMMARY RATING RATIONALE**

Moody's assigns a standalone bank financial strength rating (BFSR) of E+, which maps to a standalone baseline credit assessment (BCA) of b1, to Banco de los Trabajadores (Bantrab).

The standalone ratings reflect the bank's growing franchise as the fifth largest bank in Guatemala with a niche focus on consumer loans, particularly payroll-linked lending. The ratings also take into account Bantrab's relatively stable and granular customer-based deposit funding and low reliance on less stable sources such as short term bank borrowings and debt. The bank has gradually grown its market share in recent years through organic means and a series of local acquisitions, and is seeking to diversify its lending business by expanding the range of consumer and commercial lending products.

Key constraints to Bantrab's standalone ratings are its limited internal capital generation, particularly in light of intensifying competition from larger domestic and foreign banks that may threaten its growth, profit and diversification plans. We also note the bank's weak earnings generation and limited business diversification, partly due to its mandated role of providing consumer loans at an advantageous cost to workers, as well as to high operating outlays related to business expansion. The bank's profitability has also been burdened in recent years by credit costs related to the clean-up of legacy portfolios from its acquisitions. High loan growth, coupled with an increased focus on consumer lending and other customer segments such as commercial lending, point to potential asset quality deterioration in future.

The Ba3 local and foreign currency deposit ratings assigned to Bantrab incorporate one notch of uplift due to our assessment of the probability of systemic support in case of need. This assumption is based on the bank's franchise importance as a lender to Guatemalan public and private sector workers as well as its deposit base. A Ba3 backed foreign currency senior unsecured debt rating has also been assigned to the US\$150 million of 7-year fixed rate notes issued by Bantrab Senior Trust, a Cayman Islands-based special purpose vehicle, and guaranteed by Bantrab (please refer to "Moody's assigns Ba3 to Bantrab Senior Trust's proposed note issuance," dated 29 October 2013).

### **Rating Drivers**

Limited internal capital generation may constrain franchise development and therefore future profitability

Weak earnings generation reflecting declining profit margins, limited fee capture and relatively high operating leverage

Continued double digit loan growth points to future asset quality impairment

Stable and granular customer deposit funding; adequate liquidity

Lack of independent board limits objective oversight over asset allocation

### **Rating Outlook**

The outlook on all ratings is stable.

### **What Could Change the Rating - Up**

Upward movement in Bantrab's standalone ratings would hinge on sustainable recurring earnings growth as well as on improvements in operating efficiency, core capital and funding diversification, whilst maintaining good asset quality.

### **What Could Change the Rating - Down**

Downward pressure on standalone ratings could result from a substantial decline in overall capitalization, profitability or asset quality. Standalone ratings could also be downgraded in the case of a reversal of Bantrab's preferential creditor status.

## **DETAILED RATING CONSIDERATIONS**

LIMITED INTERNAL CAPITAL GENERATION MAY CONSTRAIN FRANCHISE DEVELOPMENT AND THEREFORE FUTURE PROFITABILITY

While Bantrab's equity is composed primarily of core capital and continues to grow, its Tier 1 capital ratios declined until 2012, reflecting high loan growth and weak earnings generation as well as charges to reserves in order to finalize the clean-up of the legacy problem loan portfolio.

As of year-end 2013, the reported Tier 1 ratio was at 11.3%, higher than the 10.3% posted by year-end 2012. However, the ratio declines to a more moderate 7% if government securities (about 25% of total assets) are 100%-weighted as prescribed by Basel for Ba-rated sovereigns and if Q91 million in goodwill from the Banco de la República acquisition is deducted. This level of adjusted core capitalization will prove a binding constraint in the case of continued double digit loan growth and hence impair Bantrab's advantage amid tightening competition from domestic banks (chiefly Banrural) and regional players such as BAC and Bancolombia. In 2013, the bank took steps to bolster its Tier 1 ratio by issuing non-voting perpetual preferred shares in the amount of Q156 million (around US\$20 million). Further, in February 2014, Bantrab grew its core capital by Q120 million (about 15% of Tier 1 capital) by increasing its capital reserves with retained earnings.

#### WEAK EARNINGS GENERATION REFLECTING DECLINING PROFIT MARGINS, LIMITED FEE CAPTURE AND RELATIVELY HIGH OPERATING LEVERAGE

Bantrab's profitability has been burdened by high credit costs following the acquisition of Banco de la República, as well as by a relatively high operating leverage, as the bank has expanded its sales force and infrastructure to support business growth. Profit margins continue to be hampered by higher than average funding costs and the bank's main focus on providing payroll-linked loans at an advantageous cost to workers, which also curbs its ability to generate fees to cover its growing operating costs. During 2013 net income grew by 63% in Quetzal terms to US\$27 million, largely as a result of a 60% drop in provisions as the clean-up of legacy loans from Banco de la República was completed. In turn, pre-provision income (PPI) grew by a more moderate 14% to 6.2% of average RWAs.

The bank's net interest margin (NIM), though much wider than the average 5.5% posted by the system because of Bantrab's consumer emphasis, continued to slide to 9.1% as of year-end 2013 from 9.8% as of year-end 2012, despite 20% loan growth. The decline reflects lower lending rates due to competition and to higher funding costs for demand deposits which accounted for around a third of total deposits as of year-end 2013. We expect NIM to come under further pressure by the senior term debt issued in November 2013, which carries a 9% fixed rate, higher than the 6% average funding cost.

On the positive side, operating expense growth has been shaved to 15% in 2013 from 26% in 2012, leading to a stable cost income ratio of 65%, though still relatively high given the bank's limited branch network. Provisions also absorbed a lower 15% of PPI, down from 43% in the prior year. As a result, returns on average assets and equity increased to 2% and 22.7%, from 1.5% and 17.4%, respectively.

#### CONTINUED DOUBLE-DIGIT LOAN GROWTH POINTS TO FUTURE ASSET QUALITY IMPAIRMENT

Bantrab's loan portfolio is mostly devoted to consumer loans (94% of total loans), of which almost entirely (96%) linked to payrolls, followed by commercial lending (5%) and residential mortgages (1%). Unsecured personal loans comprise 2% of total consumer loans while another 2% is related to unsecured credit cards. The bank's asset quality benefits from its principal focus on lower risk payroll-linked lending, 88% of which is related to public sector employees, and which displays relatively contained delinquency levels, as well as its preferential creditor status (payment preference vis-à-vis other authorized deductions) per its Organic Law. A main concern regarding asset quality going forward lies in the continuation of double-digit loan growth, which management expects to be around 30% in 2014, after 20% and 23% in 2013 and 2012, which may lead to rapid asset quality deterioration if the Guatemalan economy slows and if a tighter US monetary policy makes domestic interest rates to increase more than expected.

Bantrab's asset quality has gradually improved since 2009, reflecting the clean-up of legacy consumer and residential mortgage loans inherited through the Banco de la República acquisition. Nonperforming loans (NPLs) declined to 1.4% of loans as of year-end 2013 from a peak of 8.4% in 2009, reflecting considerable charge-off activity between 2008 and 2011 (net charge-offs rose to 3.8% of total loans in 2010 from 1.5% in 2009). About 60% of total NPLs as of year-end 2013 relates to a single project finance loan totaling Q54 million related to electricity generation. That loan was entirely provisioned as of year-end 2013.

The bank built reserves to cover problem loans, rising to 147% in 2013 from 35% in 2009. However, reserve coverage of gross loans declined to 2.1% in 2013 from 3.4% and 3.7% in 2012 and 2011. Management expects to begin rebuilding reserves again during the first quarter of 2014 with a target of 200% coverage of NPLs to be achieved by mid 2015.

## STABLE AND GRANULAR CUSTOMER DEPOSIT FUNDING; ADEQUATE LIQUIDITY

Bantrab's funding is comprised mainly (83%) of deposits, with the majority of these (61%) being sourced from individuals, which tend to be more stable than institutional deposits (23%). The majority, or 80%, is comprised of time deposits, followed by saving accounts (12%) and demand deposits (8%). The deposit base is relatively granular, with the largest 20 depositors comprising 25% of the total amount. We note however that two thirds of those largest depositors are from the public sector in line with the bank's close business ties with government entities. Senior debt comprises 10% of total liabilities while bank borrowings represent a low 2%. Subordinated loans gathered less than 1% of total funding as of December 2013, representing the financing for the purchase of Banco de la República provided by one of the government's bank resolution agencies, the "Fideicomiso Fondo Fiduciario de Capitalización Bancaria".

Tenor matches have improved with the issuance of US\$150 million in term senior debt. Liabilities maturing in more than a year comprised half of the total amount, now more in line with the long term nature of the loan book (85% due in more than a year). The proceeds of the issuance are expected to be allocated to lending (70%) and security investments (30%). The bank still shows negative cumulative tenor gaps (defined as the difference between assets and liabilities) in the 91-365 days bucket.

Bantrab maintains a large store of liquid assets on its balance sheet (39% of total assets), mainly in the form of required liquidity reserves at the central bank (35%) and Ba1-rated government securities (62%), the latter providing the bank financial flexibility in the event of a funding squeeze.

## LACK OF INDEPENDENT BOARD LIMITS OBJECTIVE OVERSIGHT OVER ASSET ALLOCATION

The lack of full board independence is a further limitation to Bantrab's standalone ratings, especially amid the existing business linkages with the government, as it increases the bank's risk profile with respect to asset quality, given the absence of full independent oversight over how the bank deploys its resources. The President of the Republic directly appoints the Chairman of the Board.

### **Business Profile**

Established by Decree Law 383 of 6 January 1966, the Organic Law of Banco de los Trabajadores, Bantrab reported total consolidated assets of US\$1.6 billion (GTQ 12.6 billion), deposits of US\$1.2 billion, and shareholders' equity of US\$137 million as of year-end 2013. 99% of the bank's common shares are widely by some 700,000 Guatemalan workers, with 1% retained by the government, which ensures the bank's mission of financial inclusion.

In 2007, Bantrab acquired Financiera Latinoamericana (now Financiera de los Trabajadores) and in 2008, Banco de la República. In 2009, Bantrab acquired insurance company Seguros Tikal, also an affiliate of Banco de la República. The entities became direct subsidiaries of Bantrab in 2010 and all together they form Grupo Financiero de los Trabajadores.

### **Global Local Currency Deposit Rating (Joint Default Analysis)**

The Ba3 local currency deposit rating for Bantrab is based on the E+ standalone BFSR that is mapped from the b1 standalone BCA and receives one notch of uplift due to our assumption of the probability of systemic support in case of need. This assumption is based on the importance of the bank's franchise as a lender to Guatemalan public and private sector workers as well as its relevant retail deposit base.

### **Notching Considerations**

Senior debt is rated similarly to deposits. Junior obligations would be subject to Moody's standard notching practices.

### **Foreign Currency Deposit Rating**

The Ba3 foreign currency deposit rating derives from the local currency rating and is unconstrained by Moody's Ba2 country ceiling for Guatemala.

### **Foreign Currency Debt Rating**

The Ba3 backed senior unsecured debt rating assigned to the senior notes issued by Bantrab Senior Trust is derived from the bank's deposit rating and is unconstrained by the Baa3 Guatemala ceiling for bonds and notes.

The notes are backed by a senior loan made to Bantrab and guaranteed by the bank.

## Rating Factors

### Banco de los Trabajadores

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
<b>Qualitative Factors (70%)</b>						<b>D-</b>	
<b>Factor: Franchise Value</b>						<b>D-</b>	
Market share and sustainability				x			
Geographical diversification					x		
Earnings stability			x				
Earnings Diversification [2]					x		
<b>Factor: Risk Positioning</b>						<b>E</b>	
<b>Corporate Governance [2]</b>					x		
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks					x		
<b>Controls and Risk Management</b>				x			
- Risk Management				x			
- Controls			x				
<b>Financial Reporting Transparency</b>				x			
- Global Comparability				x			
- Frequency and Timeliness	x						
- Quality of Financial Information				x			
<b>Credit Risk Concentration</b>			x				
- Borrower Concentration		x					
- Industry Concentration			x				
<b>Liquidity Management</b>				x			
<b>Market Risk Appetite</b>				x			
<b>Factor: Operating Environment</b>						<b>D</b>	
<b>Economic Stability</b>				x			
<b>Integrity and Corruption</b>					x		
<b>Legal System</b>			x				
<b>Financial Factors (30%)</b>						<b>B-</b>	
<b>Factor: Profitability</b>						<b>A</b>	
PPI % Average RWA (Basel I)	5.06%						
Net Income % Average RWA (Basel I)	2.43%						
<b>Factor: Liquidity</b>						<b>C+</b>	
(Market Funds - Liquid Assets) % Total Assets	-32.51%						
Liquidity Management				x			
<b>Factor: Capital Adequacy</b>						<b>B+</b>	
Tier 1 Ratio (%) (Basel I)		8.71%					
Tangible Common Equity % RWA (Basel I)	10.98%						
<b>Factor: Efficiency</b>						<b>C</b>	
Cost / Income Ratio			63.78%				
<b>Factor: Asset Quality</b>						<b>C+</b>	
Problem Loans % Gross Loans			2.20%				
Problem Loans % (Equity + LLR)		11.72%					
<b>Lowest Combined Financial Factor Score (9%)</b>						<b>C+</b>	
<b>Economic Insolvency Override</b>						<b>Neutral</b>	
<b>Aggregate BFSR Score</b>						<b>D+</b>	
<b>Aggregate BCA Score</b>						<b>baa3/ba1</b>	

Assigned BFSR		E+	
Assigned BCA		b1	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.  
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.



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