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## Research Update:

# Banco Internacional de Costa Rica 'BB/B' Ratings Affirmed; Outlook Remains Stable

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## Table Of Contents

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Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria And Research

Ratings List

## Research Update:

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## Overview

- Despite our expectation of modest loan portfolio growth, we believe Costa Rica-based bank BICSA will keep adequate business volumes in the Latin American trade finance sector.
- We are affirming our 'BB' long-term and 'B' short-term issuer credit ratings on the bank.
- We expect BICSA will keep its "adequate" business position and risk-adjusted capitalization based on its risk exposures and economic conditions in the countries the bank operates.

## Rating Action

On Oct. 10, 2013, Standard & Poor's Ratings Services affirmed its 'BB' long-term and 'B' short-term issuer credit ratings on Banco Internacional de Costa Rica S.A. (BICSA). The outlook is stable.

## Rationale

The ratings on BICSA continue to reflect our assessment of its "adequate" business and risk positions, as well as its "adequate" capital and earnings. We also continue to view its funding as "average" with "adequate" liquidity (as our criteria define these terms). The bank's stand-alone credit profile (SACP) remains at 'bb'.

We consider BICSA as a government-related entity (GRE) in the Republic of Costa Rica because of a shareholding structure, through which the country's two largest public banks wholly own BICSA. Nonetheless, we view the bank as having "limited importance" and "limited" link with the government. These assessments stem from the following:

- A "limited importance" because we believe BICSA acts as a profit-seeking bank in a very competitive environment, and its activity, in our view, could be easily undertaken by a private entity; and
- We consider there is a "limited" link with the government as a result of our belief that the government may not be willing to provide support on a timely basis.

As a result, we base the ratings on BICSA solely on its SACP, rather than on expected extraordinary support from the government.

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 BICSA has exposure through its loan book. 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'). BICSA operates mainly in Costa Rica and Panama (which accounts for around 70% of its total loan portfolio exposure) as well as other countries in Central America. As a result, the weighted economic risk for BICSA is '6'. The common factor driving this economic risk score is low income levels in the countries where the bank operates, which affect these countries' vulnerability to external shocks, and debt and payment capacity in countries with weak rule of law. The industry risk for Costa Rica, from which its two sole government-owned banks are based, is '7'. The banking system has very high credit risk, based on its high portion of dollar-denominated loans and relatively aggressive underwriting standards. Moderate credit growth and the absence of asset price bubbles partially mitigate these factors. With regard to industry risk, Costa Rica's banking industry includes a significant presence of government-owned banks, and this causes significant market distortions. Limited access to foreign markets and a narrow local debt and capital markets continue to challenge the system. Nonetheless, its retail deposit base is stable and has shown consistent growth.

We believe BICSA's business position remains "adequate" owing to its business stability and what we view as an adequate corporate strategy. Over the past several years, BICSA has been working to create a sound business model, and so far its operating performance has been adequate. The bank's business operations have not deteriorated, but they haven't shown any significant growth over the past 12 months, so we expect the bank's loan portfolio to show moderate growth rates for the next two years. This is mainly because the bank received significant loans prepayments during 2013. The bank's business activities remain geographically concentrated. As of June 2013, about 85% of its loan portfolio was concentrated in Central America, and the bank's loan portfolio remains concentrated in small economies. Therefore, we don't expect the bank's geographic concentration to change significantly in the future. However, we expect BICSA to maintain its "adequate" business position for the next 12-24 months.

We assess the BICSA's capital and earnings as "adequate," based on our forecasted risk-adjusted capital (RAC) ratio of about 8.0% average for the next 12-18 months. The forecast takes into consideration our base-case scenario, which includes the following assumptions:

- Practically no loan portfolio growth for the remainder of 2013 and a 5% growth for 2014;
- Stable net interest margins, since we don't expect significant shifts in the bank's assets and loan mix; and
- The maintenance of the bank's conservative retained earning policy.

Overall, we consider BICSA's quality of capital and earnings as "adequate," reflecting a capital base that is primarily composed of paid-in capital and retained earnings. The bank's main source of revenues is interest income and

fees & commissions, while trading income is a small revenue source, and we expect it to remain so. We also consider the bank's core earnings to average assets, of 1.3% as of June 2013, to be adequate compared to other peers; this ratio has averaged 1.2% for the past three fiscal years. This level of profitability has been stable for the past few years and we consider it to be in line with those of the bank's regional peers. We expect the bank's core earnings to average assets to be about 1.2% for the next two years.

In our opinion, BICSA's risk position remains "adequate." We base this assessment on the bank's conservative underwriting standards for the past few years, even though its loan concentration exposes it to a certain degree of volatility in its asset quality indicators. As a result of its portfolio's geographic concentration, maintaining adequate and healthy asset quality is a key credit factor for BICSA, but the short-term nature of its loan portfolio also gives it more flexibility to adapt to changing market conditions, compared with other banks in the region. Nonperforming assets (NPAs) and credit losses have been historically in line with the system's average and we deem them as adequate, particularly considering the economic risks in which the bank has exposure. NPAs as of June 2013 were 0.5% with a three-year average of 0.9%. We expect these asset quality levels to remain at current levels with no significant deterioration during the next two years, owing also to slow portfolio growth and conservative underwriting standards.

Our view of BICSA's funding remains "average", when we compare our main funding and liquidity ratios with the bank's domestic peers and other players within the same industry risk score. BICSA's main source of funding is customer deposits. As of June 2013, deposits accounted for 52.9% of the bank's total funding base. Our stable funding ratio was 97.0% as of June 2013, up from a 90.3% as of December 2012. We don't expect any significant changes regarding the bank's funding structure for the next 12-18 months. We view the bank's liquidity as "adequate." BICSA's broad liquid assets covered 1.02x its short-term wholesale funding (1.1x as of December 2012). It is important to mention that about 65% of the bank's financial obligations are due during the remainder of 2013 and in 2014. The bank is considering making a \$200 million debt issuance to refinance some debt that matures during the next 12 months. As a result, we expect this liquidity indicator to improve during the first half of 2014, leaving it at adequate levels.

## **Outlook**

The outlook on BICSA remains stable, reflecting our expectation that it will keep its presence within the trade finance segment and an "adequate" RAC, of about 8% over the next 12-18 months. A negative rating action would stem from lower RAC levels, consistently below 7%, as a result of lower internal capital generation or changes in the bank's retention earnings policy. We could also lower the ratings on BICSA if economic conditions in the countries in which it operates weaken, hampering its asset quality, resulting in worsening risk position. On the other hand, we could raise the ratings if our projected RAC ratio is higher than 10% provided that, at least, all else remains equal.

Nonetheless, we see this as less likely to happen in the near term.

## Ratings Score Snapshot

Issuer Credit Rating	BB/Stable/B
SACP	bb
Anchor	bb
Business Position	Adequate (0)
Capital and Earnings	Adequate (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

- Are Good Old Days Over For The Largest Emerging Market Banks?, Oct. 8, 2013
- Latin America Can't Avoid Slower Global Growth, Oct. 1, 2013
- Credit Conditions: Subdued Growth Is Increasing Downside Risks For Latin America, Aug. 9, 2013
- Latin American Banks' Financial Performance Remained Adequate Amid Favorable Regional Economy, June 11, 2013
- S&P Risk-Adjusted Capital Ratios Provide A Consistent Assessment Of Latin American Banks' Credit Quality, April 29, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Rating Government-Related Entities, Dec. 9, 2010
- Bank Capital Methodology and Assumptions, Dec. 6, 2010

## Ratings List

Ratings Affirmed

Banco Internacional de Costa Rica S.A.  
Counterparty Credit Rating BB/Stable/B

Complete ratings information is available to subscribers of RatingsDirect at

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