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Tanner Servicios Financieros S.A.

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Tanner Servicios Financieros S.A.

Major Rating Factors

Issuer Credit Rating
BBB-/Stable/--

Strengths:	Weaknesses:
• Very strong capitalization; and • Operates in the low-risk Chilean banking sector.	• Concentration in a cyclical and vulnerable sectors; and • Stiff competition in the Chilean financial system.

Outlook

The stable outlook on Tanner Servicios Financieros S.A. (Tanner) for the next 24 months reflects our expectation that the company will maintain an adequate competitive position in the factoring and auto loan segments, as well as its diversified operations. We also expect the company to continue to strengthen its profitability while maintaining healthy risk levels.

Upside scenario

We could raise the ratings on Tanner if its current business strategy continues to consolidate improving results and profitability and if its current business mix remains diversified, while customer concentration continues to decline and its risk appetite remains unchanged.

Downside scenario

We could lower the ratings on the company if it adopts a more aggressive risk appetite or if we see a deterioration in the company's liquidity assessment; scenarios that we view as unlikely in the short term.

Rationale

The ratings on Tanner reflect its good business position; stemming from its diversified credit operations in factoring, auto loans, corporates credit, and leasing, which provide a sustainable revenue base. Tanner's sound levels of capital continue to be its main strength. Although we expect our projected risk adjusted capital (RAC) ratio to slightly decline in 2018 after the implementation of IFRS 9 that affected the company's total capital (due to an increase in provisions), we predict capitalization levels to remain solid in coming years, with a RAC ratio of 18% in 2018-2019. On the other hand, Tanner's risk position continues to moderate our rating on the company given its high concentration in small and midsize enterprises (SMEs) through its factoring portfolio, and its exposure to cyclical segments like the auto industry. The ratings also incorporate the company's diversified funding structure compared to other finance companies--though it's all wholesale funding--and our belief that the company has enough liquidity to cover short-term maturities. Our rating on Tanner is at the same level as the 'bbb-' stand-alone credit profile (SACP) because the company doesn't benefit from external support from either the government or the group.

Anchor:'bb+' for non-bank financial institutions operating in Chile

The anchor for Chile-based non-bank financial institutions (NBFIs) is 'bb+', which incorporates a standard adjustment of three notches below the anchor for banks operating in the country. This adjustment reflects NBFIs' lack of access to the central bank's credit lines, lower regulatory oversight, and higher competitive risk than for banks.

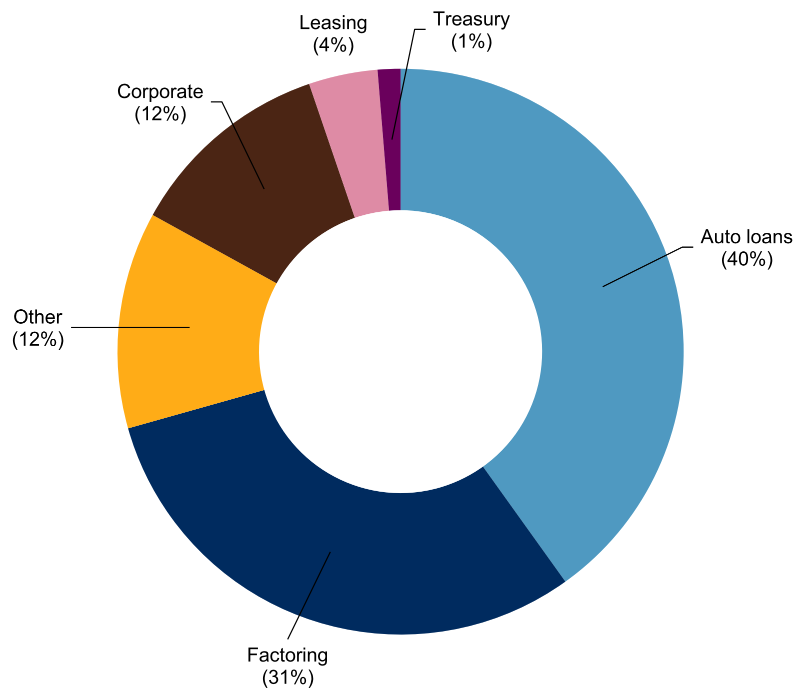
Business position: Diversified loan portfolio and solid market position in its core segments

Tanner's business position is supported by its diversified credit operations in factoring, auto loans, corporate credit, and leasing, which diversify its revenue; and its adequate market position in the factoring and auto loans business lines, its core businesses.

Tanner's loan portfolio is more diversified than those of its global peers, which mostly focus on one segment. Tanner's loan portfolio is composed of auto loans (34%), factoring (32%), corporate loans (24%), and leasing loans (10%) as of June 2018. Additionally, Tanner's subsidiaries--Tanner Corredores de Bolsa (security firm), Tanner Investments, Tanner Corredores de Bolsa de Productos S.A. (security firm), Tanner Asset Management Administradora General de Fondos S.A., and Tanner Corredora de Seguros (insurance brokerage)--also help diversify the company's business lines and revenue.

Chart 1

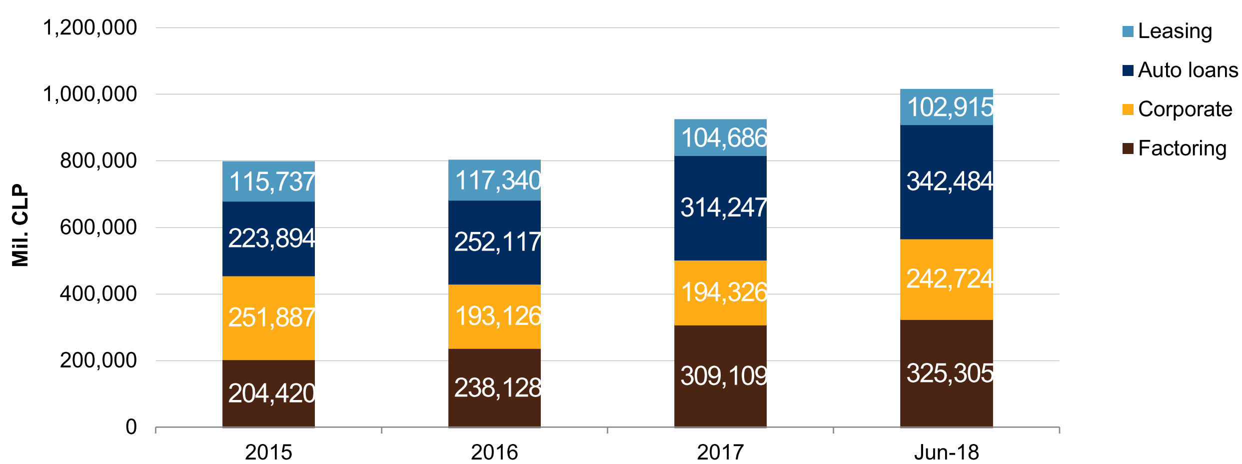
Operating Revenues per Segment
First Half of 2018



Source: S&P Global Ratings.

Chart 2

Loan Portfolio Evolution



Source: S&P Global Ratings.

As of March 2018, Tanner was the largest NBFI in the factoring segment in Chile, ranking fourth (including banks) with around 9% of market share, and ranking third in the auto loan segment with 15% of market share.

We believe Tanner has a good track record of successful and profitable operations and has a close relationship with its customers. In 2017, the company launched an app for their factoring customers. We expect Tanner to continue focusing on its core business, enhancing its relationship with factoring clients as it continues to provide new credit solutions and improve the customer experience with digital solutions. Additionally, we expect Tanner keep improving its relationship with car dealers to strengthen the stability and risk profile of the auto loan segment.

Tanner has no significant sector or geographic concentrations and its borrower concentration has declined over the last few years. Tanner's top 20 clients declined to 26% of its portfolio as of March 2018, from 35% at the end of 2015.

We also consider that Tanner has a qualified management team with long experience in financial markets and in the company's main business lines.

Table 1

Tanner Servicios Financieros S.A. Business Position

		--Year-ended Dec. 31--				
(Mil. CLP)	**2018***	**2017**	**2016**	**2015**	**2014**	**2013**
Total assets	1,211,364	1,171,846	1,020,368	956,505	822,884	723,063
Gross receivables	1,013,427	922,357	800,026	792,403	677,824	560,738
Operating revenues	50,426	90,293	82,070	81,095	79,386	76,919
Net income after extraordinaries	13,975	25,319	22,347	20,313	26,089	25,660
% change in operating revenue	21.26	10.02	1.20	2.15	3.21	25.43
Net interest margin (%)	11.05	10.51	10.18	10.68	12.48	14.94

*Data as of June 30.

Capital and earnings: Sound capitalization with a projected RAC ratio of about 18%

Tanner continues to maintain sound capitalization levels--the company's main strength. Our RAC ratio was 19.5% as of December 2017. We expect it to somewhat decline, with a projected ratio of 18% on average over the next 12-18 months, reflecting the impact on capital of the implementation of IFRS 9 in early 2018. We expect the company to keep growing its core businesses, but for capital to remain strong in a context of improved internal capital generation as Tanner's results continue to grow.

Additionally, our RAC forecast incorporates the following base-case scenario assumptions:

- Chile's real GDP growth of 4.0% in 2018 and 3.3% in 2019;
- Inflation of 2.5% in 2018 and 2.9% in 2019;
- Loan portfolio growth of 13% in 2018 and 2019, in nominal terms, driven mainly by the factoring and auto loan segments;
- Deferred tax assets (DTAs) declining in 2018 because Tanner is taking measures to reduce nonproductive assets and its deferred tax liabilities (DTLs) were reduced after Chile implemented IFRS 9 at the beginning of 2018;
- Net interest margins of about 10.5%-11.0% for the next two years;

- Administrative expenses increasing in line with inflation as the company focuses on improving efficiency;
- Core earnings to average adjusted assets of 2.6% in 2018 and 2.7% in 2019, as a result of Tanner's strategy to focus on profitability while maintaining limited risk;
- Nonperforming loans (NPLs) to total loans improving to 3% in 2018 and 2019 because of the enhanced origination standards since 2015 and changes in charge-off policies; and
- A dividend payout of about 30% of results.

Tanner has adequate quality of capital because its capital base mostly consists of common equity. The company's earnings quality has gradually increased and we expect to continue to recover to historical levels over the medium term, with return on average assets of above 3%. Since the end of 2015, Tanner has focused on improving profitability metrics while maintaining the current risk level. As of the first half of 2018, Tanner reported a net income of CLP14 billion--25% higher than the CLP11 billion reported a year before--explained mainly by higher net interest income from the factoring and auto loans segments. This is in part mitigated by higher administrative costs and higher credit loan loss provisions.

As a result, Tanner's annualized return on average assets (ROAA) was 2.35% as of June 2018, up from 2.31% registered on December 2017 and the 2.28% average for the past three fiscal years (2015-2017). We expect this metric to improve to 2.6% and 2.7% by year-end 2018 and 2019, respectively, given Tanner's focus on more profitable areas, stable administrative costs, and focus on reducing non-profitable assets in the coming years.

Table 2

Tanner Servicios Financieros S.A. Capital, Leverage, And Earnings

		--Year-ended Dec. 31--				
(%)	**2018***	**2017**	**2016**	**2015**	**2014**	**2013**
Debt/ATE (x)	2.85	2.86	2.66	2.48	2.13	1.96
Adjusted common equity/total adjusted capital	100.00	100.00	100.00	100.00	100.00	100.00
Noninterest expenses/operating revenues	42.4§	42.47	46.44	44.42	39.65	37.01
Return on average assets	2.35§	2.31	2.26	2.28	3.38	4.04
Common + preferred dividends/net income	52.94	37.32	34.67	38.14	13.57	82.96

*Data as of June 30. §Annualized.

Risk position: Operations focused on more cyclical and vulnerable sectors.

Tanner's risk position reflects that its loan portfolio has a high exposure to more cyclical and vulnerable sectors through its auto loans and SMEs factoring operations compared to the banking industry. Tanner's target clients are SMEs and corporations, while its auto lending is mostly focused on the retail segment. Factoring represents 32% of the company's total loans and auto loans 34% (of which about half are new cars). The top 20 largest exposures represent 26% of total loans and 0.9x total adjusted capital as of March 2018 (compared to 34% and 1.1x, respectively, in 2015).

Tanner doesn't have risk from complex operations and we believe that its risk appetite is adequate. Over the last two years, we've seen Tanner's asset quality metrics improve, with NPLs of 2.6% as of June 2018 compared to 4.2% and 4.5% in December 2017 and December 2016, respectively. Nonetheless, those metrics remain in line with its global peers and don't change our overall view of the company's risk profile.

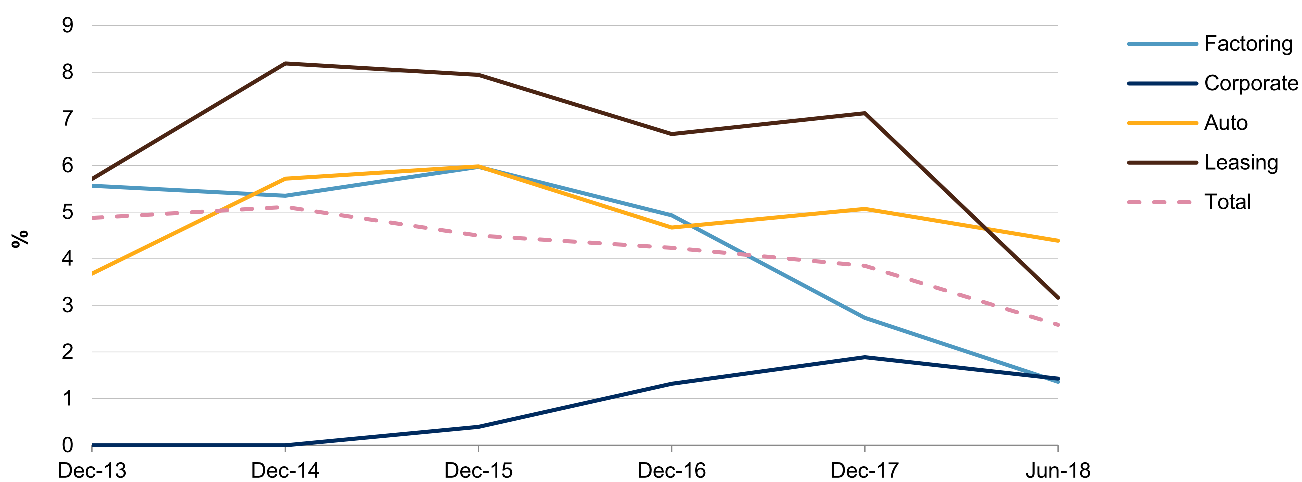
The mentioned improvement in asset quality metrics reflects that in the last few years, Tanner has implemented stricter underwriting standards for new loans, enacted stronger monitoring and collection procedures, resolved a punctual case in the factoring segment, and changed its charge-off policy. These factors have reduced Tanner's total NPLs by 33% in the first semester of 2018. Nonetheless, net charge–offs were 3.4% of average customer loans as of June 2018, up from 2.0% in December 2017 and 2.27% on average for the past three fiscal years (2017-2015). This increase is mainly explained by the mentioned change in charge off policy days, which had a one-off effect in 2018, when Tanner modified the policy.

Additionally, Tanner has improved its NPL coverage, with loan loss reserves to NPLs of 101% as of June 2018, compared to 62% at the end of 2017. At the beginning of 2018, Tanner implemented IFRS 9 in line with local regulation, increasing its provisioning levels, which was helped by the mention decline of total NPLs.

We expect NPLs to remain below 3% by the end of 2018 and 2019, since the company continues to have improved origination standards and because we expect favorable economic conditions in Chile. Additionally, we expect the net charge-off ratio to be around 4% in 2018 (because of the one-off effect from changes in the policy) but to return to historical levels of 2.0%-2.5% from 2019 onwards.

Chart 3

Asset Quality Metrics
NPLs per Segment



Source: S&P Global Ratings. NPLs--Nonperforming loans.

Table 3

Tanner Servicios Financieros S.A. Risk Position						
		--Year-ended Dec. 31--				
(%)	2018*	2017	2016	2015	2014	2013
Growth in gross receivables (YoY)	22.42§	15.29	0.96	16.90	20.88	24.42
Nonperforming assets/receivables + other real estate owned	2.58	4.24	4.48	4.97	5.76	5.09

Table 3

Tanner Servicios Financieros S.A. Risk Position (cont.)						
		--Year-ended Dec. 31--				
(%)	**2018***	**2017**	**2016**	**2015**	**2014**	**2013**
Net charge-offs/average gross receivables	3.36§	2.05	2.30	2.46	2.32	1.98
New loan loss provisions/average gross receivables	2.70§	2.79	2.39	3.33	3.19	3.51
Loan loss reserves/gross receivables	2.61	2.64	2.92	3.53	4.13	4.15
Loan loss reserves/gross nonperforming assets	101.35	62.17	65.18	71.08	71.78	81.58

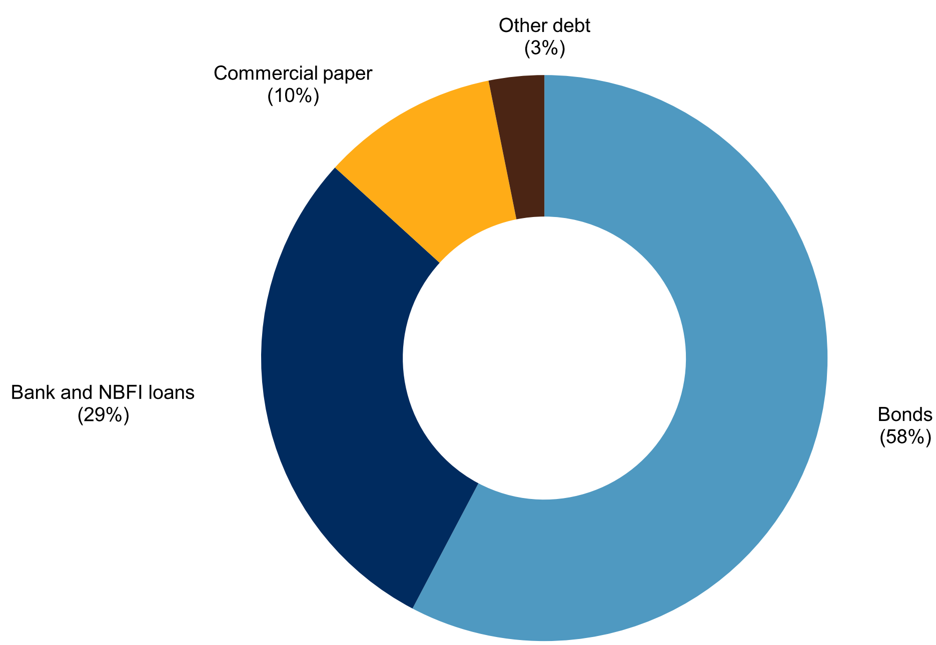
*Data as of June 30. §Annualized.

Funding and liquidity: Diversified funding base and short tenor of assets compared to liabilities

Tanner has a well-diversified funding base compared to peers, relatively easy access to multiple sources of debt, and a manageable debt maturity profile. Its stable funding ratio was below 90% at the end of June 2018. However, the mix of international and national bonds, loans from foreign and domestic banks, and commercial paper offset this ratio. Tanner has a substantial amount of approved banking lines, it frequently issues in the domestic market, and it has access to international funding. Market debt, including commercial papers and bonds in local and international markets, accounted for 68% of the company's total funding as of June 2018, while the remainder consisted of bank lines and other sources.

Chart 4

Funding Structure
As of June 2018



Source: S&P Global Ratings.

In March 2018, Tanner made the total repayment of its international 144A bond for $250 million. In addition, it issued two new bonds in the local market (in March and April 2018) and one in the international market (Switzerland, October 2017), which continues to diversify the company's funding base. Additionally, Tanner continues to be among the biggest issuers of commercial paper in the Chilean capital market. Tanner's next significant maturity is in November 2019, when its CHF150 million notes mature, which it issued in the Swiss market at the end of 2016, which we expect the company will be able to roll over. We expect Tanner's funding strategy to remain unchanged, with diversified funding for the next 12 months.

In our view, Tanner's liquidity is adequate. Our assessment incorporates our forecast of positive cash flow under base-case and stress-test scenarios while the company funds its factoring line with short-term loans. Both of these factors give Tanner significant flexibility to generate liquidity and adapt to changing economic and credit cycles. As of June 2018, its liquidity coverage ratio (LCR) was 0.2x and has averaged 0.35x for the past three fiscal years. We expect the company to maintain adequate cash flow and liquidity levels in the next 12 months.

Table 4

Tanner Servicios Financieros S.A. Funding And Liquidity

		--Year-ended Dec. 31--				
	2018*	2017	2016	2015	2014	2013
Stable funding ratio (%)	66.38	68.58	82.18	67.43	66.43	69.04
Liquidity coverage metric (x)	0.19	0.34	0.46	0.25	0.25	0.35

*Data as of June 30.

Ratings Score Snapshot

Issuer credit rating BBB-/Stable/--

SACP bbb-

Anchor bb+

Business position Adequate (0)

Capital and earnings Very strong (+2)

Risk position Moderate (-1)

Funding and liquidity Adequate and adequate (0)

Support 0

GRE support 0

Group support 0

Government support 0

Additional factors 0

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- Criteria - Financial Institutions - General: Issue Credit Rating Methodology For Nonbank Financial Institutions And Nonbank Financial Services Companies, Dec. 9, 2014
- Criteria - Financial Institutions - General: Nonbank Financial Institutions Rating Methodology, Dec. 9, 2014
- 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: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Finance Companies: Commercial Paper II: Finance Companies, March 22, 2004

Ratings Detail (As Of September 24, 2018)	
Tanner Servicios Financieros S.A.	
Issuer Credit Rating	BBB-/Stable/--
Senior Unsecured	BBB-
Issuer Credit Ratings History	
22-Aug-2018	BBB-/Stable/--
04-Aug-2017	BBB-/Negative/--
14-Jul-2017	BBB-/Watch Neg/--
27-Jan-2017	BBB-/Negative/--
Sovereign Rating	
Chile	
Foreign Currency	A+/Stable/A-1
Local Currency	AA-/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.