

Research Update:

Ratings On Banco Internacional de Costa Rica S.A. Affirmed, Outlook Stable On Financial Performance

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Overview

- Banco Internacional de Costa Rica S.A. (BICSA) is maintaining a positive trend in financial performance.
- We are affirming the counterparty credit rating on BICSA.
- The outlook remains stable.

Rating Action

On Aug. 5, 2010, Standard & Poor's Ratings Services affirmed its 'BB/B' counterparty credit rating on Banco Internacional de Costa Rica S.A. (BICSA).

Rationale

The concentration of BICSA's loan portfolio in Central America, especially in nations with long-term sovereign ratings in the 'BB' category, constrains the rating. However, the rating receives support from the positive trend in financial performance, mainly attributable to a more conservative and experienced management team.

We solely base the ratings on BICSA on its stand-alone credit profile, rather than on expected extraordinary support from the government. We consider BICSA a government-related entity (GRE) in the Republic of Costa Rica (foreign currency: BB/Stable/B; local currency: BB+/Stable/B), due to its shareholding structure where the country's two largest public banks wholly own BICSA. However, we also consider that the link between BICSA and Costa Rica's government is limited, as well as its importance to the government. Therefore, we do not consider any notches of support into the ratings.

The bank has significant exposure in Central America, with about 52% of its loans in Costa Rica, 27% in Panama, 7% in Nicaragua, 5% in El Salvador, and 4% in the U.S., while the remainder is mainly from other Central American countries as of June 30, 2010. Although the bank's exposure to nations with long-term sovereign ratings in the 'BB' category has decreased following a more conservative strategy and approach toward risk, overall exposure to 'BB' category economies still remains around 50%, and the more adverse economic conditions in these countries remain a challenge.

Enterprise risk management has strengthened and we believe it is adequate. Furthermore, we believe that BICSA has improved its credit origination processes and operational risk management. It has strengthened its management, and we expect it to continue with structural changes that will continue to enhance its financial profile. As a result of the changes it has

implemented since 2007, BICSA has improved its efficiency ratios up to 53.3% as of June 2010 from 64.5% in 2007. We expect this trend to continue and by year-end 2010, we expect efficiency to remain close to current levels. Return on assets (ROA) has also strengthened and was 1.4% by the end of the second quarter, similar to that of other banks with the same ratings.

BICSA's refocusing of its strategy toward more trade finance, corporate lending, and diversification to higher-rated countries could help it maintain nonperforming assets below 2% through 2010 and 2011. Although BICSA has been working on decreasing its main exposures, its loan portfolio still shows important concentrations by customer, exposing BICSA to large increases in nonperforming assets when a client defaults. Given the portfolio's geographic mix, the bank needs to focus on maintaining asset quality. We think adequate business prospects exist in the region where BICSA operates. The short-term nature of the bank's loan portfolio also gives it more flexibility than other banks to adapt to changing market conditions.

Outlook

The stable outlook reflects Standard & Poor's expectation that BICSA will maintain its financial performance due to its tighter operational controls, more disciplined approach to loan portfolio growth, and improved corporate governance. To raise the ratings, we would require BICSA to further diversify its asset base into countries with higher sovereign ratings than Costa Rica, as well as continue to improve the tenor and diversification of its funding structure. We could also raise the ratings if there is a positive change in the sovereign ratings of the main countries where the bank operates. We could lower the ratings if economic conditions in the countries where BICSA operates affect its loan portfolio's asset quality, profitability, and capitalization.

Related Criteria And Research

- Enhanced Methodology And Assumptions For Rating Government-Related Entities, June 29, 2009;
- FI Criteria: Bank Rating Analysis Methodology Profile, March 18, 2004; and
- Summary: Banco Internacional de Costa Rica S.A., April 9, 2009

Ratings List

Ratings Affirmed, Outlook Stable

Banco Internacional de Costa Rica S.A.

Counterparty Credit Rating

Foreign Currency

BB/Stable/B

Certificate Of Deposit

Foreign Currency

BB/B

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