

## Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Baa3/P-3
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Senior Unsecured	Baa3
Subordinate	Ba2

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## Key Indicators

### Banco Davivienda S.A. (Consolidated Financials)[1]

	[2]9-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (COP billion)	62,422.9	56,374.5	47,121.9	36,657.9	29,609.9	[3]20.5
Total Assets (USD million)	30,923.1	29,179.4	26,667.7	18,910.4	15,421.8	[3]19.0
Tangible Common Equity (COP billion)	4,251.5	3,706.2	3,070.7	3,098.7	1,854.7	[3]23.0
Tangible Common Equity (USD million)	2,106.1	1,918.4	1,737.8	1,598.5	966.0	[3]21.5
Problem Loans / Gross Loans (%)	1.6	1.6	1.8	1.6	1.5	[4]1.6
Tangible Common Equity / Risk Weighted Assets (%)	7.8	7.6	7.2	9.0	6.2	[5]7.6
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	12.2	12.4	13.4	9.6	11.0	[4]11.7
Net Interest Margin (%)	6.0	6.2	7.4	6.5	6.5	[4]6.5
PPI / Average RWA (%)	4.2	4.1	4.7	4.5	4.1	[5]4.3
Net Income / Tangible Assets (%)	1.7	1.6	1.5	1.8	2.0	[4]1.7
Cost / Income Ratio (%)	52.9	55.1	54.2	53.3	57.5	[4]54.6
Market Funds / Tangible Banking Assets (%)	16.4	17.8	16.8	18.4	16.7	[4]17.2
Liquid Banking Assets / Tangible Banking Assets (%)	18.6	20.6	21.9	22.7	21.2	[4]21.0
Gross Loans / Total Deposits (%)	100.3	101.9	100.6	101.0	100.9	[4]100.9

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 baseline credit assessment (BCA) of ba1 to Banco Davivienda S.A., which is three notches below Colombia's sovereign debt rating. The rating is based on the bank's (i) diversified banking franchise supported by significant retail lending operations and good access to core funding; (ii) good profitability, which nevertheless has not kept pace of inorganic and organic growth; and (iii) good asset quality and reserve coverage that support aggressive capitalization levels.

Davivienda would be highly eligible for government support in a situation of stress, reflecting its large market share of deposits and loans in Colombia. Davivienda's Baa3 long-term global local currency (GLC) deposit rating derives from the bank's standalone BCA of ba1 and incorporates Moody's assessment of high systemic support.

### **DAVIVIENDA'S RATING IS SUPPORTED BY A WEIGHTED MACRO PROFILE OF MODERATE**

Davivienda's operations are mainly focused on Colombia, which represents about 80% of its assets as of September 2014, and whose macro profile is Moderate+.

Colombia's robust growth outlook, supported by strong domestic demand, is tempered by the country's low GDP per capita. Despite average indicators for government effectiveness, the country benefits from a favorable investment climate and policy predictability. However, Colombia faces event risk related to its dependence on oil exports as well as ongoing problems with armed insurgencies, which have mounted an increasing number of attacks on its oil pipelines in recent years. Peace negotiations are progressing, albeit slowly.

The bank's remaining operations are focused in El Salvador where 7% of Davivienda's assets are domiciled, Costa Rica (5%), Panama (4%) and Honduras (3%), as of September 2014. While Central America provides the bank with ample geographic diversification to several countries with high GDP growth, it also exposes Davivienda to countries with high poverty and inequality indicators, coupled with low economic and institutional strength. As such, the bank's exposures adjust its macro profile downwards to Moderate.

### **Rating Drivers**

Diversified banking franchise supported by significant retail lending operations and good access to core funding

Good profitability has not kept pace of inorganic and organic growth

Good asset quality and reserve coverage support aggressive capitalization levels

### **Rating Outlook**

All ratings have a stable outlook.

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

Davivienda's aggressive capitalization is a major obstacle for upward ratings pressure.

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

Standalone ratings could be affected by a deterioration in asset quality, owing to continued high growth, or through the bank's expansion into certain less benign operating environments and highly dollarized countries in Central America.

## **DETAILED RATING CONSIDERATIONS**

### **DIVERSIFIED BANKING FRANCHISE SUPPORTED BY SIGNIFICANT RETAIL LENDING OPERATIONS AND GOOD ACCESS TO CORE FUNDING**

Davivienda has a well diversified franchise with important market shares in Colombia and Central America and a lending book that is evenly spread between wholesale and retail operations.

Davivienda is a universal bank that was initially created in 1972 as a savings and mortgage corporation (CAV). Since 2007, Davivienda has diversified its loan portfolio and expanded at a 20% compounded annual growth rate (CAGR) through both organic growth and strategic acquisitions. Davivienda has acquired several banks:

- i) Bansuperior in 2006, which was an expert in credit card financing;

ii) Bancafé (Granbanco) in 2007, which provided corporate banking, a wide branch network and international operations in Panama City and Miami;

iii) HSBC subsidiaries in El Salvador, Honduras and Costa Rica in 2012; and

iv) Corredores Asociados in 2013, a securities firm with significant presence in Colombia and Panama that complemented Davivalores.

As of September 2014, Davivienda was the third largest bank in Colombia, with an important market share of 12% of loans and 11% of deposits. The bank has presence in six countries and operates through 571 branches in Colombia, where the bank has 81% of its loans, 163 branches in El Salvador (7%), Costa Rica (5%) and Honduras (3%), four agencies in Panama City (Davivienda Internacional Panamá) (4%), and one branch in Miami, as of September 2104.

The portfolio is well diversified between commercial loans (51%), consumer (27%) and mortgages (22%), as of September 2014.

The bank's foreign franchises nevertheless expose it to increased credit, market and foreign exchange risks within several developing Central American markets with less benign and highly dollarized operating environments. The bank also faces tough competition from much larger financial groups for both loans and deposits, that may pressure its margins in Colombia, where it is the third largest bank, El Salvador (second), Costa Rica (sixth) and Honduras (sixth), in terms of assets, as of May 2014.

In Colombia, Davivienda faces competition from Bancolombia S.A. (Baa2 stable), Banco de Bogotá S.A. (Baa1 on review down), as well as from the fourth largest bank, BBVA (Baa2 stable), whilst in Central America the bank faces competition from regional powerhouses such as Banco de Bogotá's BAC Credomatic (BAC International Bank, Inc.; Baa3 stable), and Scotiabank. In addition, locally, in El Salvador, the bank faces competition from Bancolombia's Banco Agrícola, the largest bank in the country; in Costa Rica, from the two dominant government-owned banks, Banco de Costa Rica (Ba1 stable) and Banco Nacional de Costa Rica (Ba1 stable); and in Honduras, from larger domestic banks such as Occidente and Atlántida.

#### PROFITABILITY HAS NOT KEPT PACE OF INORGANIC AND ORGANIC GROWTH

Davivienda's long term profitability remains high and stable with net income to tangible assets of 1.7% as of September 2014, which is slightly below the bank's three year-end average of 1.6%.

Although expansion of profitability has lagged the bank's organic and inorganic growth, going forward, Banrepública's higher interest rates and the bank's indexation of assets and liabilities to the central bank's benchmark interest rate and/or the 90-day CD rate (DTF), should sustain ampler margins.

Davivienda's net income during the first nine months of 2014 increased 27% to COP754 billion as a result of 16% higher net interest income, in line with high 21% loan growth, and boosted by 13% lower provisions and cost controls.

The bank's net interest margin remains ample but follows a downward trend to 6.0% through September 2014, from 6.2% during 2013 and 7.4% during 2012.

#### GOOD ASSET QUALITY AND RESERVE COVERAGE SUPPORT AGGRESSIVE CAPITALIZATION LEVELS

Davivienda's low levels of problem loans and high loan loss reserve (LLR) coverage support its aggressive capitalization levels.

As of September 2014, 90+ days past due loans (problem loans) represented 1.6% of gross loans, coupled by an ample LLR coverage of problem loans of 249.3%. The problem loan ratio for the foreign operations is 1.7% versus LLR coverage of problem loans of 150.1%.

Nevertheless, Davivienda's consolidated tangible common equity (TCE, common stock plus retained earnings minus goodwill) to risk weighted assets is a low 6% as of September 2014. Furthermore, the bank's unadjusted Tier 1 ratio of 6.5% and fully adjusted Tier 1 ratio of 4.7% are also low. Moody's adjustments for the bank's Tier 1 ratio are related to the

a) Deduction of grandfathered goodwill mainly created with the acquisition of Bancafé/Granbanco, and

b) Risk-weighting government securities at 50%, in line with the Colombian government's Baa2 bond rating.

Despite Davivienda's single-major shareholder (family ownership), the bank maintains best practices in corporate governance which are reflected in almost null related party lending and funding. The bank has a well experienced management team and a longstanding relationship with the International Finance Corporation (IFC, initial investment in 1973) which encourages Davivienda's high corporate governance standards.

Davivienda is the largest subsidiary of the Colombian economic conglomerate Grupo Bolívar which controls 55.8% (55.9% with preferred shares) of the bank. Other major shareholders include Inversiones Cúsezar (17.6%, 18.0% with preferred shares) and the IFC (2.0%). Also 22.2% of the bank's capital is held by minority shareholders (excluding Bolívar and Cúsezar preferred shares) and including those shares that are publicly traded in the Colombian stock exchange.

## Notching Considerations

In the absence of a bail-in resolution regime framework in Colombia, as per the "Global Banks" Methodology, under "Guidelines for Rating Junior Bank Obligations", updated in July 2014, we take into account the key features of the bank's outstanding notes. As 'plain vanilla' subordinated debts with no skip mechanisms, these instruments commonly absorb losses only in a liquidation scenario. In those cases, the notching approach for 'plain vanilla' subordinated debt is one notch of subordination risk off the bank's adjusted baseline credit assessment (BCA) of the issuer.

## Government Support

We believe there is a high likelihood of government support for Davivienda's rated wholesale deposits and senior unsecured debt. This reflects Davivienda's large market share of deposits and loans in Colombia and hence the material systemic consequences that would result from an unsupported failure. Davivienda's deposit rating benefits from one notch uplift from government support, at this instance.

## About Moody's Bank Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

## Rating Factors

### Banco Davivienda S.A.

<b>Macro Factors</b>	
<b>Weighted Macro Profile</b>	<b>Moderate</b>

<b>Financial Profile</b>						
<b>Factor</b>	<b>Historic Ratio</b>	<b>Macro Adjusted Score</b>	<b>Credit Trend</b>	<b>Assigned Score</b>	<b>Key driver #1</b>	<b>Key driver #2</b>
<b>Solvency</b>						
<b>Asset Risk</b>						
<i>Problem Loans / Gross Loans</i>	1.7%	baa1	← →	baa2	Loan growth	
<b>Capital</b>						
<i>TCE / RWA</i>	7.8%	b3	← →	b3	Access to capital	
<b>Profitability</b>						
<i>Net Income / Tangible Assets</i>	1.6%	baa1	← →	baa1	Earnings quality	

<b>Combined Solvency Score</b>		ba1		ba1		
<b>Liquidity</b>						
<b>Funding Structure</b>						
<i>Market Funds / Tangible Banking Assets</i>	17.8%	baa3	← →	baa3	Deposit quality	
<b>Liquid Resources</b>						
<i>Liquid Banking Assets / Tangible Banking Assets</i>	20.6%	ba1	← →	ba1	Quality of liquid assets	
<b>Combined Liquidity Score</b>		baa3		baa3		

<b>Financial Profile</b>
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<b>ba1</b>
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<b>Qualitative Adjustments</b>
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<b>Adjustment</b>
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Business Diversification
Opacity and Complexity
Corporate Behavior

0
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0
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0
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<b>Total Qualitative Adjustments</b>
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0
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Sovereign or Affiliate constraint
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Baa2
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Scorecard Calculated BCA range
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baa3 - ba2
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<b>Assigned BCA</b>
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<b>ba1</b>
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Affiliate Support notching
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0
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<b>Adjusted BCA</b>
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<b>ba1</b>
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Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	0	0	ba1	1	Baa3	Baa3
Senior unsecured bank debt	0	0	ba1	1		Baa3
Dated subordinated bank debt	-1	0	ba2	0		Ba2

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