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### CREDIT OPINION

11 January 2018

#### Update

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#### RATINGS

##### Banco Davivienda S.A.

Domicile	Colombia
Long Term Debt	Baa3
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Baa3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Banco Davivienda S.A.

### Update to credit analysis

#### Summary

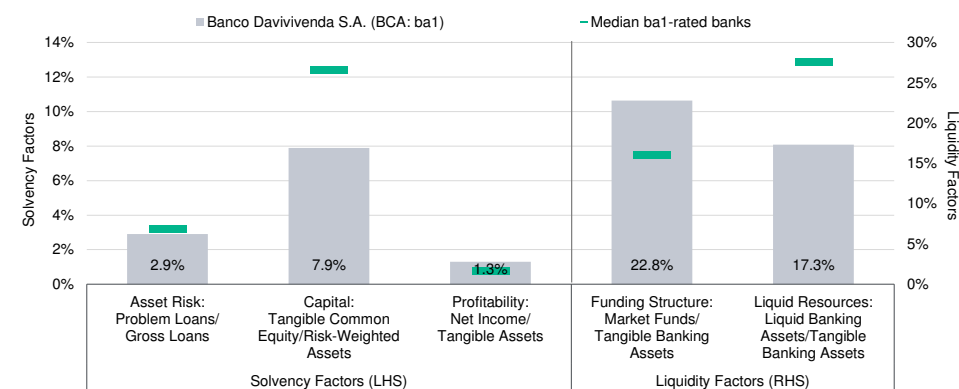
Moody's assigns a ba1 standalone baseline credit assessment (BCA) and ba1 Adjusted BCA to Colombia's Banco Davivienda S.A. (Davivienda), which reflects the bank's diversified banking franchise supported by significant retail lending operations and access to core funding. Also, it incorporates the asset quality deterioration in the last year, which also resulted in declining net income. However, profitability remains positioned at sound levels, reflecting its adequate efficiency, attractive net interest margins and strong market positioning. Tangible common equity to risk weighted assets has slightly increased in the last year, following the slowdown in asset growth and the capitalization of retained earnings, but remains at low levels. The bank's capacity to sustain capital ratios at higher levels will be important to counterbalance the negative pressures of the economic environment in its financial profile.

Davivienda's deposit and debt ratings of Baa3 are in line with Moody's assessment of high government support in a situation of stress, reflecting its large market share of deposits and loans in Colombia as well as its importance to the payment system.

Exhibit 1

#### Rating Scorecard - Key Financial Ratios

Data for Davivienda as of September 2017.



Source: Moody's Financial Metric

## Credit challenges

- » Capitalization remains low
- » Asset risk will remain pressured by the weak economy

## Credit strengths

- » Good access to core funding
- » Despite the decline in the last year, profitability is still positioned at sound levels

## Rating outlook

Davivienda's ratings have a stable outlook, incorporating a stabilization in asset risk and profitability at current levels, and also, the sustainability of capital ratio at a level that counterbalances the negative pressures of the weak economy.

## Factors that could lead to an upgrade

The bank's ratings would face upward pressure if tangible common equity to risk weighted assets were to increase substantially, coupled with improvements in asset risk and profitability.

## Factors that could lead to a downgrade

Davivienda's BCA of ba1 could come under negative pressure if the asset risk further deteriorates, the profitability records additional weakening, or if the bank is unable to sustain a capitalization that offsets the negative pressures from the economic environment.

## Key indicators

Exhibit 2

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

	9-17 <sup>2</sup>	12-16 <sup>2</sup>	12-15 <sup>2</sup>	12-14 <sup>2</sup>	12-13 <sup>3</sup>	CAGR/Avg. <sup>4</sup>
Total Assets (COP billion)	98,558	93,548	83,718	68,117	56,374	14.4 <sup>5</sup>
Total Assets (USD million)	33,560	31,162	26,372	28,663	29,179	5.9 <sup>5</sup>
Tangible Common Equity (COP billion)	6,934	6,468	5,170	4,428	3,706	17.7 <sup>5</sup>
Tangible Common Equity (USD million)	2,361	2,154	1,629	1,863	1,918	9.0 <sup>5</sup>
Problem Loans / Gross Loans (%)	2.9	1.9	1.6	1.8	1.6	2.0 <sup>6</sup>
Tangible Common Equity / Risk Weighted Assets (%)	7.9	7.6	6.7	7.1	7.1	7.3 <sup>7</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	24.3	17.1	14.6	15.6	12.4	17.9 <sup>6</sup>
Net Interest Margin (%)	5.8	5.8	5.8	5.5	6.2	5.7 <sup>6</sup>
PPI / Average RWA (%)	4.3	4.5	4.2	3.5	3.8	4.1 <sup>7</sup>
Net Income / Tangible Assets (%)	1.3	1.9	1.5	1.5	1.6	1.5 <sup>6</sup>
Cost / Income Ratio (%)	46.9	46.6	47.8	50.9	55.4	48.1 <sup>6</sup>
Market Funds / Tangible Banking Assets (%)	23.5	22.8	23.8	22.1	16.1	23.1 <sup>6</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	17.8	17.3	18.8	19.0	20.6	18.2 <sup>6</sup>
Gross Loans / Due to Customers (%)	124.2	122.3	121.3	118.0	113.4	121.4 <sup>6</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Basel I; LOCAL GAAP [4] May include rounding differences due to scale of reported amounts

[5] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [6] Simple average of periods presented for the latest accounting regime. [7]

Simple average of Basel II periods presented

Source: Moody's Financial Metrics

## Profile

Banco Davivienda S.A. (Davivienda), a Colombian universal bank, provides banking and other financial products and services, including deposit and savings accounts, loans, mortgages and leasing facilities to retail, microfinance, small and medium-sized enterprise (SME), corporate and commercial clients, as well as to public authorities. As of September 2017, it was the country's second-largest

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commercial bank (out of 25) in terms of gross loans (with a market share of 14.8% only considering Colombia's operations), and the third largest in terms of deposits (13.0%) and assets (13.4%). As of the same date, it reported total consolidated assets of COP98.6 trillion (\$33.6 billion).

As of September 2017, Davivienda distributed its products through 753 offices operating in six countries. Davivienda was established in 1972 as a savings and mortgage corporation named Corporación Colombiana de Ahorro y Vivienda. Its preference shares have been listed on the Colombian Stock Exchange since 2010 (ticker: PFDVVNDA). As of September 2017, the bank's largest shareholder was Grupo Bolívar S.A., which owned 55.2% of its total share capital.

## Detailed credit considerations

### Slow economy will keep pressuring asset risk

Davivienda's loan portfolio is almost equally distributed between loans to households and corporations. In the consumer side, about 46% consists of mortgage loans and 54% of consumer lending. The loan growth continues to decelerate steadily, with a 9% year over year increase in September 2017, from 15% a year before. Although all segments are slowing down, commercial loans are experiencing the sharpest deceleration, reflecting the weak economy and difficulties faced by corporations.

The weaker macro environment has also led to meaningful increases in 90-day past due loan ratios, to 2.9% of total loans in September 2017, which is almost 90 basis points higher in one year. This trend was significantly impacted by the commercial loan exposures, mainly associated with certain large problematic exposures. The deterioration was also driven by the mortgage loan portfolio, pressured by the exposures to lower-income individuals.

Following the deterioration of the asset quality, Davivienda has been increasingly consuming its loan loss reserves, which represented 99% of problem loans in September 2017, down from 144% a year before. We anticipate that the bank will have to keep building additional reserves not only because asset risks will remain elevated, and potentially increasing, but also because the reserves to cover Electricaribe's risk will be raised.

We also highlight that the bank's relevant exposure to Central America, equivalent to 20% of its loan portfolio, exposes the bank to operating environments that sometimes can be more volatile, as well as to higher foreign exchange risks.

### Capitalization remains low despite the improvement in the last year

Davivienda reported a low tangible common equity to risk weighted assets, of 7.9% in September 2017, up from 7.3% a year before. The bank's capital is negatively weighted by the large stock of goodwill, which is mainly related to the acquisition of Bancafé/Granbanco.

In the last year the bank consumed less capital, with risk weighted assets growing at 7.9% in the 12 months ended in September 2017, down from the two-digit pace of growth in the last years and the same time the bank has capitalized COP1.4 billion in retained earnings. We expect Davivienda's capital position to remain stable under a slower growth environment if it avoids recording further increases in dividend payouts, which represented 46% of net income in the 9 months ended in September 2017, versus 33% in the same period of 2016. At the same time, we also note that the bank could manage to report some improvement in capital if it decides to divest the remaining stock of real estate assets, in line with the strategy that was carried out in 2016.

### Credit costs will continue to impact profitability

Davivienda's net income to tangible assets declined to 1.27% in the 9 months ended in September 2017, from 1.88% in 2016. The bank's results were mainly impacted by higher credit costs, in line with the asset quality deterioration, with expenses with loan loss provisions equivalent to 2.6% of average loans up to September 2017, from 1.8% in 2016.

The bank's results are also impacted by the slower loan growth coupled with slight negative pressures in the net interest margins, given the declining benchmark interest rates. At the same time, Davivienda is still facing a relatively high growth in operating expenses, equivalent 12% on a year over year basis.

Finally, bottom line results in Q3 2016 include an extraordinary income of around COP307 billion related to Credibanco S.A. (unrated). This extraordinary gain was divided in COP200 billion product of the sale of fixed assets (commercial and administrative offices) and COP107 billion product of the conversion of Credibanco into a "Sociedad Anónima" (S.A.) in which Davivienda received stock from Credibanco.

Going forward, we expect the bank's profitability to remain pressured by the ongoing weakness of the economy, which will keep credit costs at high levels and contain the growth of revenues.

### Access to core funding contains the need to raise market funds

Davivienda has a well-diversified core deposit franchise with important market shares in Colombia and Central America, resulting in a loan-to-deposit ratio of 1.2x in September 2017.

Davivienda is the third largest bank in Colombia, with important market share of loans and deposits. The bank operates through 594 branches in Colombia, where the bank has 80% of its loans, 131 branches in El Salvador (7%), Costa Rica (7%) and Honduras (3%), six agencies in Panama City (Davivienda Internacional Panamá) (3%), and one branch in Miami.

Finally, bottom line results in Q3 2017 were lower when compared with the same period last year as the bank reported an extraordinary income of around COP307 billion. This extraordinary gain was divided in COP200 billion product of the sale of fixed assets (commercial and administrative offices) and COP107 billion product of the conversion of Credibanco S.A. (unrated) to a "Sociedad Anónima" (S.A.) in which Davivienda received stock from Credibanco S.A.

The bank's presence in different markets provides opportunity for gathering core deposits and reduce dependence on market funds, which were equivalent to 23.5% of tangible banking assets in September 2017. The bank's loan to deposit ratio has been stable in the last years, while funding is further supported by the resources from development bank financing.

At the same time, the bank holds modest levels of liquid banking assets at 17.8% of tangible banking assets in September 2017.

### Davivienda's rating is supported by the weighted Macro Profile of "Moderate"

Davivienda's operations are mainly focused on Colombia, which represents around 80% of its loan portfolio, which Macro Profile is "Moderate+."

Despite the lower expectations of GDP growth, the economy will remain resilient, as it continues to adjust to lower oil prices, and benefits from its sound fiscal framework and adequate reserve buffers. Our evaluation of Colombia's macro profile is nevertheless tempered by the country's low GDP per capita and high inequality. Despite below average indicators for government effectiveness, the country benefits from a favorable investment climate and policy predictability. Colombia faces event risk related to its dependence on oil exports.

The bank's remaining operations are focused in El Salvador (Macro Profile of "Very Weak+") representing 7% of Davivienda's loans, Costa Rica (7%, Macro Profile of "Moderate-"), Panama (4%, Macro Profile of Moderate) and Honduras (3%, no rated banks). While Central America provides the bank with ample geographic diversification to several countries with high GDP growth, it also exposes Davivienda to countries with potentially more volatile operating environments. As such, the bank's weighted average Macro Profile is adjusted downward to Moderate.

## Support and structural considerations

### 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.

### Counterparty risk assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion if the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.e., swaps), letters of credit, guarantees and liquidity facilities.

**Davivienda's CR Assessment is positioned at Baa2(cr) / Prime-2(cr)**

The CR assessment is one- notch above the deposit rating of the bank, reflecting Moody's view that its probability of default is lower at the operating obligations than of deposits.

**Foreign currency debt rating**

The Baa3 long-term foreign currency debt rating of Davivienda's five-year senior debt issuance of USD500 million due 29 January 2018 (coupon of 2.95%) is based on Moody's evaluation of high government support, leading to a one-notch uplift from the bank's ba1 standalone BCA<sup>1</sup>.

The Ba2 foreign currency debt rating assigned to Davivienda's ten-year subordinated debt in foreign currency of USD500 million due 9 July 2022 (coupon of 5.875%) reflects one notch of subordination from Davivienda's ba1 standalone BCA, in line with Moody's standard notching practices for plain vanilla subordinated debt issuances<sup>2</sup>.

**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 methodology and scorecard factors

Exhibit 3

Banco Davivienda S.A.

### Macro Factors

<b>Weighted Macro Profile</b>	<b>Moderate</b>	<b>100%</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>
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.9%	baa2	← →	baa2	Quality of assets	
Capital						
TCE / RWA	7.9%	b3	← →	b3	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	1.3%	baa2	← →	baa1	Return on assets	
Combined Solvency Score		ba2		ba1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	22.8%	ba1	← →	ba1	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	17.3%	ba2	← →	ba2	Stock of liquid assets	
Combined Liquidity Score		ba1		ba1		
Financial Profile				ba1		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Baa2		
Scorecard Calculated BCA range				baa3-ba2		
Assigned BCA				ba1		
Affiliate Support notching				0		
Adjusted BCA				ba1		

<b>Instrument class</b>	<b>Loss Given Failure notching</b>	<b>Additional Notching</b>	<b>Preliminary Rating Assessment</b>	<b>Government Support notching</b>	<b>Local Currency Rating</b>	<b>Foreign Currency Rating</b>
Counterparty Risk Assessment	1	0	baa3 (cr)	1	Baa2 (cr)	--
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

Source: Moody's Financial Metrics

## Ratings

Exhibit 4

Category	Moody's Rating
<b>BANCO DAVIVIENDA S.A.</b>	
Outlook	Stable
Bank Deposits	Baa3/P-3
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	Baa2(cr)/P-2(cr)
Senior Unsecured	Baa3
Subordinate	Ba2

Source: Moody's Investors Service

## Endnotes

- <sup>1</sup> See Moody's Press Release entitled "[Moody's rates Davivienda's proposed senior debt issuance](#)," 22 January 2013
- <sup>2</sup> See Moody's Press Release entitled "[Moody's rates Davivienda's proposed subordinated debt issuance](#)," 27 June 2012.

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