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CREDIT OPINION

13 March 2018

Update

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RATINGS

Banco Davivienda S.A.

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

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.

Contacts

Alcir Freitas 55-11-3043-7308
VP-Sr Credit Officer
alcir.freitas@moodys.com

Vicente Gomez 52-55-1555-5304
Associate Analyst
vicente.gomez@moodys.com

Felipe Carvallo 52-55-1253-5738
VP-Senior Analyst
felipe.carvallo@moodys.com

Aaron Freedman 52-55-1253-5713
Associate Managing Director
aaron.freedman@moodys.com

Banco Davivienda S.A.

Update following change in ratings outlook to negative

Summary

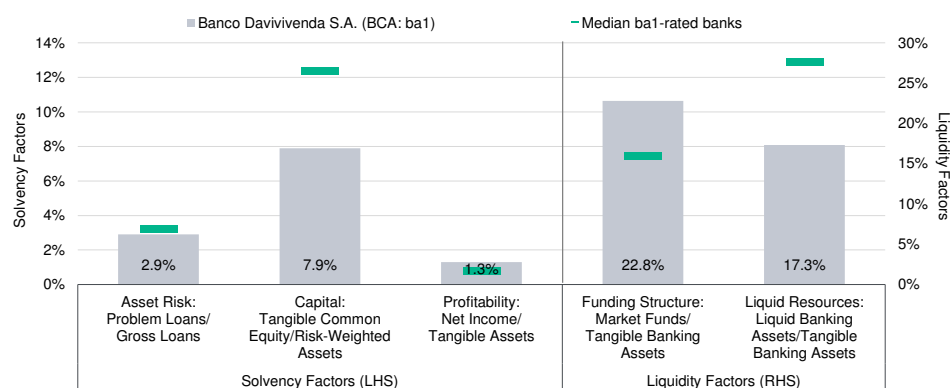
Banco Davivienda S.A.'s (Davivienda) baseline credit assessment (BCA) of ba1 is facing negative pressures given the deterioration of its asset risk and profitability metrics over the past year, which we expect will continue in light of the slow anticipated recovery of Colombia's economic growth. The increase in problem loans is mainly associated with rising non-performing loans in its mortgage and commercial loan portfolios. Also, we note that Davivienda will likely be required to make additional provisions against its existing problematic exposures to rebuild its loan loss reserve coverage, which declined in the last year. As a result, high credit costs and relatively slow loan growth continue to pressure net income, although Davivienda's profitability remains competitive with Latin America peers and strong compared to banks in other regions. At the same time, Davivienda's financial profile is supported by the improvement in the bank's capitalization over the last twelve months, due to the slowdown in loan growth as well as the capital gain recorded in early 2017 from the sale of real estate assets. Slow loan growth has also reduced pressures on the bank's liquidity and on its need to raise market funds.

Davivienda's deposit and senior unsecured debt ratings of Baa3 incorporate Moody's assessment that there is a high probability that Davivienda will benefit from government support in an event of financial stress given its meaningful market share of local deposits. This results in one notch of ratings uplift from the bank's adjusted BCA of ba1.

Exhibit 1

Rating Scorecard - Key Financial Ratios

Data for Davivienda as of September 2017.



Source: Moody's Financial Metric

Credit challenges

- » Asset risk will remain pressured by the effects of economic growth deceleration and slow recovery
- » Slow growth and high credit costs will keep impacting profitability

Credit strengths

- » Good access to core funding and stable liquidity
- » Capitalization has improved in the last year

Rating outlook

Davivienda's ratings have a negative outlook, reflecting the deterioration of the bank's asset risk and profitability metrics over the past year, which we expect will continue in light of the slow anticipated recovery of Colombia's economic growth.

Factors that could lead to an upgrade

While an upgrade of Davivienda's ratings is unlikely given the bank's negative outlook, the outlook could be stabilized if the bank manages to halt the deterioration of its asset quality and earnings and preserve its current capitalization levels even as loan growth begins to accelerate.

Factors that could lead to a downgrade

Davivienda's ratings could be downgraded if asset risk and profitability continue to deteriorate and/or the bank is unable to sustain capitalization at current levels. However, the ratings would not be affected by a downgrade of Colombia's sovereign bond rating of Baa2, which also has a negative outlook.

Key indicators

Exhibit 2

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

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

[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

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

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 December 2017, it was the country's second-largest commercial bank (out of 25) in terms of gross loans (with a market share of 14.7% only considering Colombia's operations), and the third largest in terms of deposits (12.7%) and assets (13.5%). As of September 2017, Davivienda 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: PFDAVVNDA). 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 recovery in economic growth will keep pressuring asset risk

The baa3 assigned score for asset risk captures the meaningful deterioration in problem loans in the last 12 months, as well as our expectation that it will keep facing pressures derived from last years' deceleration in the economy, although the weakening is likely subside. Also, asset risk assessment captures the decline in loan loss reserve coverage, while the reserves for specific large corporate problems will require additional provisions over time.

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 9.2% year over year increase in September 2017, from 15.2% a year before, reflecting the slowdown in the economy and the bank's lowering risk appetite, particularly in commercial loans given the difficulties faced by certain large 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. Going forward, although asset quality pressures will remain, we expect the deterioration will subside given the gradual recovery in the economy, and also considering that the impact from large corporate problems will diminish.

Also, asset quality was meaningfully impacted by the growing past due loans in the mortgage segment, associated with the increasing unemployment, as well as with the high growth rates reported by Davivienda in this segment in the last two years, of around 15%, outpacing the average market growth in Colombia. Also, Davivienda was impacted by increasing delinquency in social housing mortgages without government-subsidized interest rates, and we note that the bank is more exposed than its peers to social housing mortgages, which are more sensitive to economic downturns.

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. If we include the reserves recorded in other comprehensive income, then the coverage is equivalent to 152% in September 2017, down from 194% in previous year. We anticipate that the bank will have to keep building additional reserves not only because asset risks will remain elevated, but also because the reserves to cover large corporate problems will likely 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.

Rising capitalization partially counterbalances risks

The b1 assigned score for capital captures the bank's current capital position and our expectation that it will remain stable, supported by healthy internal earnings generation and slow asset growth.

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. Furthermore, capitalization was positively affected by a COP200 billion capital gain recorded in March 2017, arising from the sale of fixed assets (commercial and administrative offices).

Considering that Davivienda will maintain its dividend payout ratio of 30%, in line with the distribution in the last years, the capital position will remain at least stable under a slower growth environment.

In terms of regulatory capital, Davivienda Basic capital ratio of 7.8% is higher than the 4.5% minimum, while the 12.5% total capital ratio is properly positioned versus the 9.0% requirement.

Credit costs and slow growth will continue to impact profitability

The baa2 assigned score for profitability captures the negative pressures in the last years, mainly arising from loan loss provisions and slower growth, while it also incorporates the expectation that credit cost will accommodate at high levels in the next 12 months.

Davivienda's net income to tangible assets declined to 1.27% in the 9 months ended in September 2017, from 1.88% in 2016, which were mainly impacted by higher credit costs, which achieved 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.

Despite the negative pressures, we note that Davivienda's profitability remains at somewhat high levels, which in turn, is supporting the maintenance of adequate internal earnings generation, and ultimately sustaining capital enhancement. Going forward, we expect the bank's profitability to remain pressured, as it keeps building provisions for the large problematic exposures and the lagging effects from the economic slowdown keeps weighting on asset quality.

Access to core funding and reduced loan growth contains the need to raise market funds

The ba1 score for funding structure incorporates the bank's moderate reliance on market funds, representing 23.5% of banking assets, supported by its sound branch size, positioned among Colombia's top-4 networks. It also considers that funding needs will remain low under the slow growth environment.

Davivienda is the third largest bank in Colombia, with important market share of loans and deposits. The bank operates through 591 branches in Colombia, where the bank has 79% of its loans, 138 branches in El Salvador (7%), Costa Rica (7%) and Honduras (3%), six agencies in Panama City (Davivienda Internacional Panamá) (4%), and one branch in Miami.

The bank's presence in different markets provides opportunity for gathering core deposits and reduce dependence on market funds, which are 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, at around 105%, which further improves if we include development bank financing.

The ba2 score for liquid resources captures the moderate volume of liquidity, which is mainly consisted of highly liquid instruments. It also considers that consumption of liquidity will remain low under the slow growth environment.

Liquid banking assets represented 17.8% of tangible banking assets in September 2017, which has been relatively stable in the last years. Most of the liquid resources are invested in low-risk assets, consisted mainly of cash, balances with the central bank and government bonds of Colombia.

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+". Colombia's macro profile reflects the country's predictable macroeconomic policies and growth that remains higher than that of most rating peers despite a slowdown in recent years. Colombia has shown resilience to economic and political shocks, including a large terms-of-trade shock that resulted from the drop in global oil prices to which it is still adjusting. Growth remains weak, consumer and business confidence hover around record lows, and there is uncertainty regarding the fiscal cost of implementing the country's newly approved peace deal. However, the government has implemented medium-term tax reforms to meet fiscal targets while inflation and interest rates are falling. The expected gradual recovery through 2018 will be primarily linked to improved domestic demand and ongoing developments in 4G infrastructure investments. In line with lower economic growth, credit growth

has decelerated substantially, and is expected to remain modest compared to previous years given lower demand and tighter loan underwriting standards. However, high borrower concentration will remain a structural risk of the banking industry, as shown by the impact on asset risk and profitability of problems at a few large corporate borrowers. At the same time, high concentration in the banking system itself supports banks' pricing power and ample lending spreads.

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, therefore resulting in the bank's weighted average Macro Profile of "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, denominated in Colombian Pesos and settled in an equivalent amount of USD, due 24 October 2022 (coupon of 7.5%) is based on Moody's evaluation of high government support, leading to a one-notch uplift from the bank's ba1 standalone BCA¹.

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 issuances².

About Moody's Bank Scorecard

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Rating methodology and scorecard factors

Exhibit 3

Banco Davivienda S.A.

Macro Factors

Weighted Macro Profile	Moderate	100%
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Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.9%	baa2	← →	baa3	Quality of assets	Collateral and provisioning coverage
Capital						
TCE / RWA	7.9%	b3	← →	b1	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	1.3%	baa2	← →	baa2	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		

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
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
BANCO DAVIVIENDA S.A.	
Outlook	Negative
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

- ¹ See Moody's Press Release entitled "[Moody's rates Banco Davivienda's proposed senior unsecured notes Baa3; stable outlook](#)" 12 October 2017
- ² See Moody's Press Release entitled "[Moody's rates Davivienda's proposed subordinated debt issuance](#)," 27 June 2012.

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Analyst Contacts

M. Celina Vansetti 212-553-4845
Managing Director -
Banking
celina.vansetti-hutchins@moody.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454