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CREDIT OPINION
14 July 2017

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.

Semiannual Update

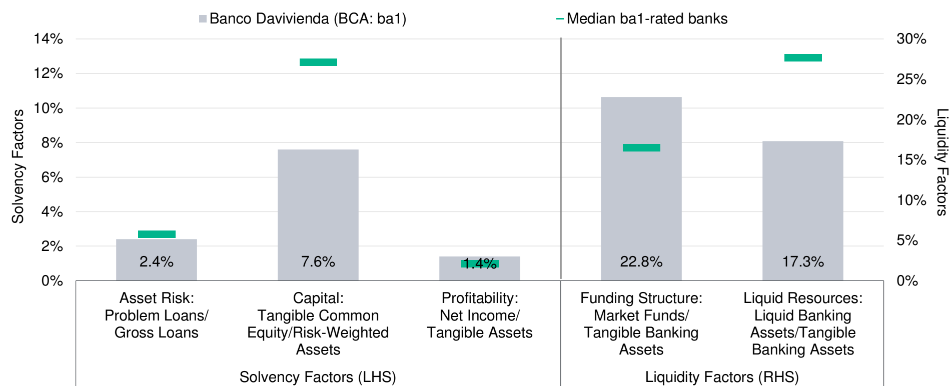
Summary Rating Rationale

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, access to core funding, and good asset quality and reserve coverage. Profitability remains strong, but earnings growth has lagged the bank's overall expansion, which has been driven by both organic growth and acquisitions. Despite an increase of about 90 basis points (bps), in the last year, capitalization is still a key rating constraint and it is low when compared with similar rated banks in the globe. Current core capital levels can limit loss absorption in an eventual situation of stress. Davivienda's Baa3/Prime-3 deposit ratings 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 payments system.

Exhibit 1

Rating Scorecard - Key Financial Ratios

Data for Davivienda as of March 2017.



Source: Moody's Financial Metric

Credit Challenges

» Despite a 90bps increase in the last year, capitalization remains modest

» Likely deterioration of asset quality will test Davivienda's good risk management

Credit Strengths

» Good access to core funding

» Attractive profitability levels, although asset risk will keep posing downward pressures

Rating Outlook

Davivienda's ratings have a stable outlook reflecting the bank's diversified business supported by significant retail lending operations, access to core funding, and good asset quality and reserve coverage.

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 and sustainably and/or asset quality improved.

Factors that Could Lead to a Downgrade

Davivienda's BCA of ba1 could come under negative pressure if the growth leads to a deterioration in asset quality, or profitability weaken. Capital adequacy is also modest and therefore could generate ratings volatility if it weakens.

Key Indicators

Exhibit 2

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

	3-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[3]	CAGR/Avg.[4]
Total Assets (COP billion)	95,072	93,548	83,718	68,117	56,374	16.0[5]
Total Assets (USD million)	32,853	31,162	26,372	28,663	29,179	6.3[5]
Tangible Common Equity (COP billion)	6,399	6,468	5,170	4,428	3,706	17.8[5]
Tangible Common Equity (USD million)	2,211	2,154	1,629	1,863	1,918	7.9[5]
Problem Loans / Gross Loans (%)	2.4	1.9	1.6	1.8	1.6	1.9[6]
Tangible Common Equity / Risk Weighted Assets (%)	7.6	7.6	6.7	7.1	7.1	7.3[7]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	21.1	17.1	14.6	15.6	12.4	17.1[6]
Net Interest Margin (%)	5.9	5.8	5.8	5.5	6.2	5.8[6]
PPI / Average RWA (%)	4.4	4.5	4.1	3.5	3.8	4.1[7]
Net Income / Tangible Assets (%)	1.4	1.9	1.5	1.5	1.6	1.6[6]
Cost / Income Ratio (%)	45.7	46.6	47.8	50.9	55.4	47.8[6]
Market Funds / Tangible Banking Assets (%)	21.8	22.8	23.8	22.1	16.1	22.7[6]
Liquid Banking Assets / Tangible Banking Assets (%)	18.2	17.3	18.8	19.0	20.6	18.3[6]
Gross Loans / Due to Customers (%)	119.2	122.3	121.3	118.0	113.4	120.2[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

Detailed Rating Considerations

SLOW ECONOMY WILL KEEP PRESSURING ASSET QUALITY

Davivienda's loan portfolio is almost equally distributed between loans to households and corporations. In the consumer side, about 45% consists of mortgage loans and 55% of consumer lending. The loan portfolio is still growing at reasonable levels of 10.9% year over year, despite the deceleration from the 22% growth pace in the previous year. The main driver has been consumer and mortgage lending, while commercial loans slowed down to one-digit levels, reflecting the bank's tighter approach in this segment.

The bank's problem loan ratio increased by almost 50bps in the last twelve months ended in March 2017, to 2.4%. This trend was significantly impacted by the commercial loan exposures, which represents about 50% of the total portfolio. The deterioration was observed in both small and medium sized enterprises (SMEs), and was also influenced by large problematic loans in the energy distribution and commercialization industry that affected many important banking system's players in 2016.

Following the deterioration of the asset quality, Davivienda has consumed a portion of its loan loss reserves, which represented 108% of problem loans in March 2017, down from 158% a year before. We anticipate that the bank will have to build additional reserves not only because asset risks will remain elevated, but also because the reserves to cover Electricaribe's risk will likely have to increase.

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

Davivienda is the largest subsidiary of the Colombian economic conglomerate Grupo Bolívar, which controls 55.2% of the bank. Other major shareholders include Inversiones Cúsezar (17.5%, 17.8% with preferred shares) and the IFC (1.9%). Also 23.9% of the bank's capital is held in preferred shares by minority shareholders, excluding Bolívar and Cúsezar.

CAPITALIZATION REMAINS MODEST, DESPITE A 90BPS INCREASE IN THE LAST YEAR

Davivienda reported a low tangible common equity to risk weighted assets, of 7.6% in March 2017, up from 6.7% 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 5.7% in the 12 months ended in March 2017, down from 22% in the previous year. We expect Davivienda's capital position to remain stable under a slower growth environment if it avoids deviating materially from current dividend payout policy.

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. Tangible common equity nominally increased 25% in 2016 vis-à-vis 2015 or 19.4% to COP6,399 billion as of March 2017 from COP5,357 billion as of the same period last year.

PROFITABILITY THOUGH AMPLE, WILL LIKELY FACE DOWNWARD PRESSURE

Davivienda's profitability remains high despite the negative pressures arising from higher credit costs. The bank's results are supported by ample net interest margin, which is expected to improve as the interest rates in Colombia keep declining, and deposits reprice faster than loans. The low cost to income ratio, at about 46%, also support its earnings generation capacity.

Going forward, we expect the bank's profitability to remain in line with last year as the pressures arising from high loan loss provisions and slower growth will be counterbalanced by the slight expansion of net interest margin.

GOOD ACCESS TO CORE FUNDING

Davivienda has a well-diversified core deposit franchise with important market shares in Colombia and Central America. Deposits represent 65% of total assets as of March 2017.

Davivienda is the third largest bank in Colombia, with important market share of loans and deposits. The bank operates through 597 branches in Colombia, where the bank has 79% of its loans, 130 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 21.8% of tangible banking assets in March 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.

At the same time, the bank holds modest levels of liquid banking assets at 18.2% of tangible banking assets in March 2017.

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

Davivienda's operations are mainly focused on Colombia, which represents around 79% 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.

Notching 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.

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 June 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[1].

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 5.95%) 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[2].

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.

Historical Ratios

For the asset risk and profitability ratios, we calculate the average of the three latest year-end numbers and the latest quarterly data if available, and the ratio used is the weaker of the average versus the latest period. For the capital ratio, we use the latest reported figure. For the funding structure and liquid resources ratios, we use the latest year-end figures.

Rating Methodology and Scorecard Factors

Exhibit 3

Banco Davivienda S.A.

Macro Factors		
Weighted Macro Profile	**Moderate**	**100%**

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.4%	baa2	←→	baa2	Loan growth	
Capital						
TCE / RWA	7.6%	b3	←→	b3	Expected trend	
Profitability						
Net Income / Tangible Assets	1.4%	baa2	↑	baa1	Expected trend	
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	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

1 See Moody's Press Release entitled "Moody's rates Davivienda's proposed senior debt issuance," 22 January 2013

2 See Moody's Press Release entitled "Moody's rates Davivienda's proposed subordinated debt issuance," 27 June 2012.

REPORT NUMBER 1081134

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