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### CREDIT OPINION

19 January 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.

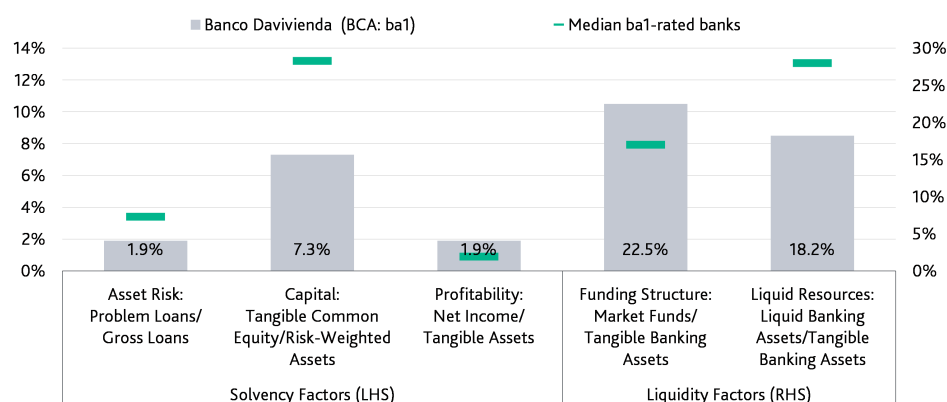
### Semiannual Update

#### 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. Davivienda's low capitalization levels are a key rating constraint and limit loss absorption in an eventual situation of stress.

Exhibit 1

#### Rating Scorecard - Key Financial Ratios Data for Davivienda as of September 2016.



Source: Moody's Financial Metrics

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.

#### Credit Challenges

- » Modest capitalization
- » Likely deterioration of asset quality will test Davivienda's good risk management
- » Profitability, though ample, will likely face downward pressure



## Credit Strengths

- » Good access to core funding
- » Davivienda's Weighted Macro Profile is "Moderate" reflecting exposure to Central America

## Rating Outlook

All of 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 or if 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 if capitalization or profitability weaken. Capital adequacy is modest and therefore could generate ratings volatility if capitalization weakens.

## Key Indicators

Exhibit 2

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

	9-16 <sup>2</sup>	12-15 <sup>2</sup>	12-14 <sup>2</sup>	12-13 <sup>3</sup>	12-12 <sup>3</sup>	Avg.
Total Assets (COP billion)	90,734.1	83,718.3	68,117.2	56,374.5	47,121.9	15.4 <sup>4</sup>
Total Assets (USD million)	31,504.7	26,372.1	28,663.0	29,179.4	26,667.7	4.8 <sup>4</sup>
Tangible Common Equity (COP billion)	5,923.1	5,170.1	4,428.4	3,706.2	3,070.7	15.7 <sup>4</sup>
Tangible Common Equity (USD million)	2,056.6	1,628.6	1,863.4	1,918.4	1,737.8	5.1 <sup>4</sup>
Problem Loans / Gross Loans (%)	2.0	1.6	1.8	1.6	1.8	1.8 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	7.3	6.7	7.1	7.1	6.8	7.0 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	17.9	14.6	15.6	12.4	13.4	16.0 <sup>5</sup>
Net Interest Margin (%)	6.1	5.8	5.5	6.2	7.4	5.8 <sup>5</sup>
PPI / Average RWA (%)	4.7	4.1	3.5	3.8	4.6	4.1 <sup>6</sup>
Net Income / Tangible Assets (%)	1.8	1.5	1.5	1.6	1.5	1.6 <sup>5</sup>
Cost / Income Ratio (%)	42.9	47.8	50.9	55.4	54.2	47.2 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	22.6	23.8	22.1	16.1	16.8	22.9 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	17.6	18.8	19.0	20.6	21.9	18.5 <sup>5</sup>
Gross loans / Due to customers (%)	121.6	121.3	118.0	113.4	114.6	120.3 <sup>5</sup>

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Basel I; LOCAL GAAP [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel II & IFRS reporting periods have been used for average calculation

Source: Moody's Financial Metrics

## Detailed Rating Considerations

### MODEST CAPITALIZATION

Davivienda reported a low tangible common equity (TCE, common stock plus retained earnings minus goodwill) to risk weighted assets of 7.6% as of September 2016. The bank's goodwill is mainly related to the acquisition of Bancafé/Granbanco. Moody's adjusts RWAs by risk-weighting government securities at 50%, in line with the Colombian government's Baa2 bond rating.

Capital adequacy is modest and therefore could generate ratings volatility if capitalization weakens.

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**PROFITABILITY, THOUGH AMPLE, WILL LIKELY FACE DOWNWARD PRESSURE**

Davivienda's long-term profitability remains high with net income to tangible assets of 1.8% as of September 2016. The bank's net interest margin remains ample at 6.2%, from 5.8% during 2015. Bottom line profitability however will likely face downward pressure stemming from higher provisioning efforts as a result of expected deterioration of loans, particularly in the consumer segment.

During the first nine months of 2016, Davivienda's net income increased 29.7% to COP1.2 trillion when compared to the same period a year ago, benefitting from a strong 22.3% increase in net interest income versus the bank's 15.1% loan portfolio expansion. The bank's net income also benefitted from subdued 13.9% expansion in operating expenses.

**LIKELY DETERIORATION OF ASSET QUALITY WILL TEST DAVIVIENDA'S GOOD RISK MANAGEMENT**

Likely deterioration of consumer loans as a result of the slow economy will test the bank's asset risk profile. Davivienda is relatively more exposed to economic cycles based on its higher focus on retail lending than most larger peers in Colombia, whereby about 50% of its loans are directed to consumer financing and residential mortgages. The economic deceleration, translating to an up tick in unemployment will affect borrowers' loan repayment capacity, and therefore we expect loan deterioration through 2017.

Davivienda's low levels of problem loans and high loan loss reserve (LLR) coverage support its aggressive capitalization levels. As of September 2016, 90+ days past due loans (problem loans) represented 2.0% of gross loans, up slightly from 1.6% as of year-end 2015, coupled by an ample LLR coverage of problem loans of 143.8%, though down from 167.0%.

Davivienda's asset quality is also supported by a lending book that is evenly spread between wholesale and retail operations. While the portfolio is well diversified between commercial loans (53.4%), consumer (25.3%) and mortgages (21.4%), as of September 2016, the bank's foreign franchises expose it to increased credit, market and foreign exchange risks within several developing Central American markets with less benign and highly dollarized operating environments. We nevertheless expect a controlled deterioration in asset quality going forward related to slower lending in the context of much slower economic growth in Colombia.

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 long standing relationship with the International Finance Corporation (IFC, initial investment in 1973) which encourages Davivienda's sound corporate governance. Loans to related parties composed a low 2.7% of tangible common equity (TCE), as of September 2016.

Davivienda is the largest subsidiary of the Colombian economic conglomerate Grupo Bolívar, which controls 55.1% of the bank. Other major shareholders include Inversiones Cúezar (17.4%, 17.7% with preferred shares) and the IFC (1.9%). Also 22.0% of the bank's capital is held in preferred shares by minority shareholders, excluding Bolívar and Cúezar.

**GOOD ACCESS TO CORE FUNDING**

Davivienda has a well-diversified core deposit franchise with important market shares in Colombia and Central America. Deposits represent 64.1% of total assets as of September 2016.

Davivienda is the third largest bank in Colombia, with important market share of loans and deposits. The bank operates through 595 branches in Colombia, where the bank has 79% of its loans, 129 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, as of September 2016.

The bank's presence in different markets provides opportunity for gathering core deposits and reduce dependence on market funding, as a result, the bank's market funding levels are somewhat low at 22.6% of tangible banking assets leading as of September 2016. The bank's loan to deposit ratio has remained stable at 122%, as of September 2016, however, if we include development bank financing and USD financing that is used to finance the bank's USD loan book, this ratio decreases substantially to about 90%; both of which are sourced for matched onlending.

Nevertheless, the bank holds modest levels of liquid banking assets at 17.6% of tangible banking assets as of September 2016.

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

Davivienda's operations are mainly focused on Colombia, which represents 76.1% of its loan portfolio as of September 2016, and whose 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 where 7% of Davivienda's loans are domiciled and whose Macro Profile is "Very Weak+," Costa Rica (7%, Macro Profile of "Moderate-"), Panama (4%, Macro Profile of Moderate) and Honduras (3%, no rated banks), as of September 2016. 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.

## 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<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 5.95%) 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<sup>2</sup>.

### 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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### Financial Profile

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.0%	baa2	← →	baa2	Loan growth	
Capital						
TCE / RWA	7.3%	b3	← →	b3	Expected trend	
Profitability						
Net Income / Tangible Assets	1.6%	baa1	↓	baa1	Earnings quality	
Combined Solvency Score		ba1		ba1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	23.8%	ba1	← →	ba1	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	18.8%	ba2	← →	ba2	Quality 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
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### 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

- <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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