MOODY'S
INVESTORS SERVICE

Credit Opinion: Banco Davivienda S.A.

Global Credit Research - 21 Dec 2015

Colombia

Ratings

Category	Moody's Rating
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

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Key Indicators

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

	[2]**9-15**	[3]**12-14**	[3]**12-13**	[3]**12-12**	[3]**12-11**	**Avg.**
Total Assets (COP billion)	**80,828.8**	**67,470.6**	**56,374.5**	**47,121.9**	**36,657.9**	**--**
Total Assets (USD million)	**26,182.9**	**28,391.0**	**29,179.4**	**26,667.7**	**18,910.4**	**--**
Tangible Common Equity (COP billion)	**5,698.6**	**4,603.0**	**3,706.2**	**3,070.7**	**3,098.7**	**--**
Tangible Common Equity (USD million)	**1,846.0**	**1,936.9**	**1,918.4**	**1,737.8**	**1,598.5**	**--**
Problem Loans / Gross Loans (%)	**1.9**	**1.6**	**1.6**	**1.8**	**1.6**	[4]**1.9**
Tangible Common Equity / Risk Weighted Assets (%)	**8.0**	**7.7**	**7.6**	**7.2**	**9.0**	[5]**8.0**
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	**15.5**	**12.2**	**12.4**	**13.4**	**9.6**	[4]**15.5**
Net Interest Margin (%)	**5.7**	**6.0**	**6.2**	**7.4**	**6.5**	[4]**5.7**
PPI / Average RWA (%)	**4.4**	**4.2**	**4.0**	**4.7**	**4.5**	[5]**4.4**
Net Income / Tangible Assets (%)	**1.8**	**1.6**	**1.6**	**1.5**	**1.8**	[4]**1.8**
Cost / Income Ratio (%)	**46.8**	**52.4**	**55.4**	**54.2**	**53.3**	[4]**46.8**
Market Funds / Tangible Banking Assets (%)	**24.3**	**17.0**	**16.1**	**16.8**	**18.4**	[4]**24.3**
Liquid Banking Assets / Tangible Banking Assets (%)	**18.8**	**18.9**	**20.6**	**21.9**	**22.7**	[4]**18.8**
Gross loans / Due to customers (%)	**120.9**	**116.8**	**113.4**	**114.6**	**116.6**	[4]**120.9**

Source: Moody's

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

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a ba1 standalone baseline credit assessment (BCA) and ba1 Adjusted BCA to Banco Davivienda S.A. (Davivienda) in line with the bank's diversified banking franchise, which is 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.

Moody's also assigns long- and short-term global local and foreign currency deposit ratings of Baa3/Prime-3 and long-term foreign currency senior unsecured debt rating of Baa3 to Davivienda in line with the rating agency's assessment of high government support in a situation of stress for the bank, reflecting the bank's large market share of deposits and loans in Colombia as well as its importance to the payments system. The bank's deposit and senior debt ratings benefit from one notch of government support uplift. The bank's long-term foreign currency subordinate debt rating of Ba2, one notch below Davivienda's ba1 BCA, in line with Moody's notching practices for these types of debt instruments. Moody's also assigns long- and short-term Counterparty Risk (CR) Assessments of Baa2(cr)/Prime-2(cr) to Davivienda.

All of Davivienda's ratings have a stable outlook.

Rating Drivers

Ample profitability has not kept pace of inorganic and organic growth

Good asset quality and reserve coverage

Modest capitalization

Good access to core funding

Moderate macro profile

Rating Outlook

All of Davivienda's ratings have a stable outlook.

What Could Change the Rating - Up

The bank's ratings would face upward pressure if tangible common equity to risk weighted assets were to increase or if asset quality improved.

What Could Change the Rating - Down

Davivienda's BCA of ba1 could come under negative pressure if the bank's continued high growth leads to a decline in asset quality, or if capitalization or profitability weaken.

Corporate Profile

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, including:

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.

In Colombia, Davivienda faces high competition from Bancolombia S.A. (Baa2/Baa2 stable, baa3), Banco de Bogotá S.A. (Baa2/Baa2 stable, baa3), as well as from the fourth largest bank, BBVA Colombia S.A. (Baa2/- stable, baa3), whilst in Central America the bank faces competition from regional powerhouses such as Banco de Bogotá's BAC (BAC International Bank, Inc. Baa3/- stable, baa3), and Scotiabank. In addition, locally, in El Salvador, the bank faces competition from Bancolombia's Banco Agrícola, S.A. (Ba2/Ba2 stable, ba3), the largest bank in the country; in Costa Rica, from the two dominant government-owned banks, Banco de Costa Rica (Ba2/Ba1 stable, ba2) and Banco Nacional de Costa Rica (Ba2/Ba1 stable, ba2); and in Honduras, from larger domestic banks such as Occidente and Atlántida.

DETAILED RATING CONSIDERATIONS

AMPLE PROFITABILITY HAS NOT KEPT PACE OF INORGANIC AND ORGANIC GROWTH

Davivienda's long-term profitability remains high with net income to tangible assets of 2.3% as of September 2015, higher than the bank's three year-end average.

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 in the short-term.

The bank's net interest margin remains ample but follows a downward trend to 5.8% through September 2015, from 6.0% during 2014 and 6.2% during 2013, mainly as a result of high competition.

During the first nine months of 2015, Davivienda's net income almost doubled, reaching COP451 billion, from September 2014's COP247 billion, due to a 20.5% expansion in net interest income along with only 3% increase in operating costs.

GOOD ASSET QUALITY AND RESERVE COVERAGE

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

As of September 2015, 90+ days past due loans (problem loans) represented 1.9% of gross loans, coupled by an ample LLR coverage of problem loans of 150.5%. The problem loan ratio for the foreign operations is 1.7% versus LLR coverage of problem loans of 150.1%.

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 (53.2%), consumer (25.6%) and mortgages (21.2%), as of September 2015, 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 its high loan growth, within the context of much slower economic growth in Colombia, and increased credit, market and foreign exchange risks related to Central American expansion.

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 sound corporate governance. Loans to related parties composed a low 2.3% of tangible common equity, as of September 2015.

Davivienda is the largest subsidiary of the Colombian economic conglomerate Grupo Bolívar, which controls 56.0% of the bank. Other major shareholders include Inversiones Cúsezar (17.6%, 18.0% with preferred shares) and the IFC (2.0%). Also 22.3% 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.

MODEST CAPITALIZATION

Davivienda reported a low tangible common equity (TCE, common stock plus retained earnings minus goodwill) to risk weighted assets of 8.0% as of September 2015. The bank's goodwill is mainly related to the acquisition of Bancafé/Granbanco. Moody's adjusts RWAs by risk-weighing government securities at 50%, in line with the Colombian government's Baa2 bond rating.

GOOD ACCESS TO CORE FUNDING

Davivienda has a well-diversified core deposit franchise with important market shares in Colombia and Central America. Deposits represent 62.8% of total assets as of September 2015.

As of September 2015, Davivienda was the third largest bank in Colombia, with an important market share of 12.9% of loans and 11.5% of deposits. The bank operates through 571 branches in Colombia, where the bank has 79% 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 December 2014.

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 24.3% of tangible banking assets leading as of September 2015. The bank's loan to deposit ratio has nevertheless deteriorated to 120.9%, as of September 2015, as loans expanded at 30.7% year-over-year versus deposit growth of 22.0%.

Nevertheless, the bank holds low levels of liquid banking assets at 18.8% of tangible banking assets as of September 2015.

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 2015, 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 and high inequality. Despite average indicators for government effectiveness, the country benefits from a favorable investment climate and policy predictability. However, Colombia faces event risks 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 and whose Macro Profile is Weak, Costa Rica (6%, Macro Profile of Moderate-), Panama (4%, Macro Profile of Moderate) and Honduras (4%, no rated banks), 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.

Notching Considerations

In the absence of a bail-in resolution regime framework in Colombia, as per Moody's "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.

Foreign Currency Debt Rating

Moody's assigns a foreign currency debt rating of Ba2 to Davivienda's ten-year subordinated debt in foreign currency of USD500 million due 9 July 2022 (coupon of 5.95%) and a Baa3 long term foreign currency debt rating to Davivienda's five-year senior debt issuance of USD500 million due 29 June 2018 (coupon of 2.95%).

Counterparty Risk Assessments

Davivienda's long- and short-term CR Assessments are positioned at Baa2(cr)/Prime-2(cr).

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 of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

The CR Assessment, prior to government support, is positioned one notch above the Adjusted BCA of ba1 and therefore above senior unsecured and deposit ratings, reflecting our view that its probability of default is lower than that of senior unsecured debt and deposits. We believe senior obligations represented by the CR Assessment will be more likely preserved in order to limit contagion, minimize losses and avoid disruption of critical functions.

The CR Assessment also benefits from one notch of systemic support, in line with our support assumptions on deposits and senior unsecured debt. This reflects our view that any support provided by governmental authorities to a bank which benefits senior unsecured debt or deposits is very likely to benefit operating activities and obligations reflected by the CR Assessment as well, consistent with our belief that governments are likely to maintain such operations as a going-concern in order to reduce contagion and preserve a bank's critical functions.

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.

Macro Factors	
Weighted Macro Profile	**Moderate**

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	1.7%	baa1	←→	baa2	Loan growth	
Capital						
TCE / RWA	7.7%	b3	↑↑	b2	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	17.0%	baa3	←→	baa3	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	18.9%	ba2	←→	ba2	Quality of liquid assets	
Combined Liquidity Score		ba1		ba1		

Financial Profile	**ba1**

Qualitative Adjustments	**Adjustment**
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**
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

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 http://www.moodys.com for the most updated credit rating action information and rating history.

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