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CREDIT OPINION

11 March 2019

Update

 Rate this Research

RATINGS

Banco Davivienda S.A.

Domicile	Colombia
Long Term CRR	Baa2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
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.

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Banco Davivienda S.A.

Update to credit analysis

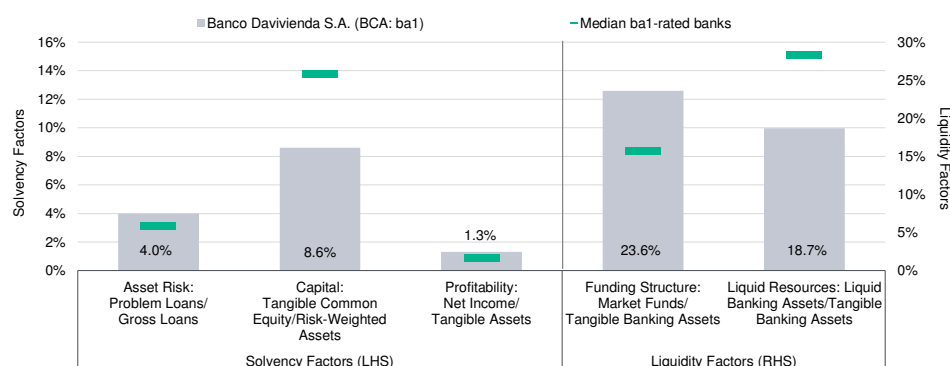
Summary

Banco Davivienda S.A.'s (Davivienda) baseline credit assessment (BCA) of ba1 is facing negative pressures given the increase on its asset risk and high credit costs. 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, especially in its commercial loan book to rebuild its loan loss reserve coverage.

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 2018.



Source: Moody's Financial Metric

Credit challenges

- » Asset risk will remain pressured by large problematic loans in the bank's commercial portfolio
- » Credit costs will continue to impact profitability

Credit strengths

- » Good access to core funding and stable liquidity
- » Capitalization has improved in the last year, though still is moderate

Outlook

Davivienda's ratings have a negative outlook, reflecting the deterioration of the bank's asset risk and higher credit costs over the past year.

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 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 continue to deteriorate and profitability or capital is hurt by that deterioration. 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]

	9-18 ²	12-17 ²	12-16 ²	12-15 ²	12-14 ²	CAGR/Avg. ³
Total Assets (COP billion)	104,533	100,771	93,548	83,718	68,117	12.1 ⁴
Total Assets (USD million)	35,203	33,764	31,162	26,372	28,663	5.6 ⁴
Tangible Common Equity (COP billion)	7,882	7,313	6,468	5,170	4,428	16.6 ⁴
Tangible Common Equity (USD million)	2,654	2,450	2,154	1,629	1,863	9.9 ⁴
Problem Loans / Gross Loans (%)	4.0	4.8	1.9	1.6	1.8	2.8 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	8.6	8.3	7.7	6.8	7.1	7.7 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	29.1	39.1	17.1	14.6	15.6	23.1 ⁵
Net Interest Margin (%)	5.9	5.8	5.8	5.8	5.5	5.8 ⁵
PPI / Average RWA (%)	4.4	4.3	4.5	4.2	3.5	4.2 ⁶
Net Income / Tangible Assets (%)	1.3	1.3	1.9	1.5	1.5	1.5 ⁵
Cost / Income Ratio (%)	47.0	47.7	46.6	47.8	50.9	48.0 ⁵
Market Funds / Tangible Banking Assets (%)	23.4	23.6	22.8	23.8	22.1	23.2 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	16.8	18.7	17.3	18.8	19.0	18.1 ⁵
Gross Loans / Due to Customers (%)	126.1	123.5	122.3	121.3	118.0	122.2 ⁵

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel II; IFRS. [3] May include rounding differences due to scale of reported amounts. [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5] Simple average of periods presented for the latest accounting regime. [6] 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 2018, it was the country's second-largest financial entity in terms of gross loans (with a market share of 15% only considering Colombia's operations), and reported total consolidated assets of COP104.5 trillion (\$35.2 billion), as of September 2018.

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). The bank's largest shareholder was Grupo Bolívar S.A., which owned 56.9% of its total share capital as of September 2018.

Detailed credit considerations

Asset risk will remain pressured by large problematic loans in the bank's commercial portfolio

The baa3 assigned score for asset risk captures the meaningful deterioration in problem loans in the last 12 months. Consolidated non performing loans were about 3.96% of the bank's gross loans as of September, presenting a deterioration of 109 bps compared to the reported in the same period last year. The portfolio that most affected the bank's asset quality was the commercial one, which deterioration is explained by the troubled large clients in the infrastructure and transportation sectors.

According to what was disclosed in the last earnings call the bank still have as non performing credits those granted to Electrificadora del Caribe S.A. E.S.P. (Electricaribe), mass transportation systems in different cities Colombia and Concesionaria Ruta del Sol S.A.S II (CRDS II), according to the last disclosed amount the exposure to these projects was about COP1.9 trillion. We expect that these problematic loans will continue to represent one of the largest components of the bank's non performing loans as consumer NPL start to subside in a faster pace as the bank's benefit from the positive momentum of Colombia's economy and the implementation of new origination policies and collection strategies that had helped to reverse the deterioration trend in this segment.

As of September 2018, the 90 days mortgage NPL closed at 3.89%, presenting an increase of 66 bps when compared to the one reported in the same period last year, the deterioration in this particular portfolio was explained by the vintages issued in the second half of 2016 and the first half of 2017, that were impacted by the slower economic growth of that time. Our expectation is that as the outlook of Colombian economy improves the quality of mortgage portfolio also improves.

Rising capitalization partially counterbalances asset 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 8.6% in September 2018, up from 8.1% 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 5.8% in the 12 months ended in September 2018.

Considering that Davivienda will maintain its dividend payout ratio of 32% in line with the latest paid dividend as of September 2018, the capital position will remain at least stable under a slower growth environment.

In terms of regulatory capital, Davivienda Basic capital ratio of 8.4% is higher than the 4.5% minimum, while the 12.3% total capital ratio is properly positioned versus the 9.0% requirement.

Credit costs 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, while it also incorporates the expectation that credit cost will accommodate at high levels in the next 12 months.

The bank has provisioned a hefty 65% of Electricaribe's exposure but provisions for mass transportation systems and CRDS II at 34% and 13% as of September 2018. Depending on how these situations will place out more provisions may be required. Also the tax

reform recently approved in Colombian congress will negatively impact profitability in next year. According to management projection the reform will increase 120 bps its effective tax rate (effective tax rate was 24% as of year end 2017).

Davivienda's net income for the first nine months ended in September of 2018 that reached COP1.0 trillion, which indicates an annual increase of 10.9%. This explained by the following positive drivers: 1) growth of loan income, related to higher mortgage and consumer loans, 2) the decrease in financial expenses, 3) higher operating income, and 4) the bank continues to run an efficient operation, reflected by the 47.0% cost to income ratio.

However the provision expenses, net of recoveries increased 6.7% year-on-year as of September 2018 given the deteriorations on particular clients from the commercial portfolio, and higher provision expenses on consumer and mortgage loans, as a consequence of the implementation of the expected loss model consistent with IFRS 9 standard.

Cost of risk remained considerable higher than the historical average at 2.5% (1.9% in the first six months of 2017), this is explained by the aforementioned deteriorations in Colombia and the adoption of IFRS 9, while in Central American operations cost of risk was negatively affected by the deterioration of Costa Rica's portfolio. All in all, provisions continue to consume a very high 52.6% ¹ of the bank's pre provision income (35% in 2016) being the main drag on the bank's bottom-line that closed at 1.3% of tangible banking assets.

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 23.4% 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.

The bank's presence in different markets provides opportunity for gathering core deposits and reduce dependence on market funds. The bank's loan to deposit ratio has been stable in the last years, at around 123.9%, which further improves if we include development bank financing.

The bank's liquid resources remained moderate but consists of highly liquid instruments, as most of them are invested in low-risk assets, consisted mainly of cash, balances with the central bank and government bonds of Colombia. While liquidity declined to 16.8% as September 2018, these levels are still consistent with the assigned ba2 score.

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 "Moderate +" macro profile reflects the country's relatively large and resilient economy and history of predictable policymaking, balanced against a relatively high dependence on commodities and sensitivity to trade shocks, and borrower concentration in the banking system.

Notwithstanding some fiscal tightening coupled with tight monetary policy, the economy continued to expand. Nevertheless, growth potential will remain lower than it was in the past given our expectation that oil prices will remain relatively low by recent historical standards.

Despite high exposure to terms of trade shocks, external vulnerabilities are limited by the country's adequate foreign exchange buffers and access to a sizeable credit line from the IMF. Moreover, the effectiveness of the government's policy response to recent commodity shocks illustrates the country's moderate institutional strength.

In line with lower economic growth, credit growth has decelerated substantially, and credit to GDP remains relatively modest. While banks are largely deposit funded, a substantial portion of these are provided by institutions, leaving banks potentially vulnerable to funding concentration risk. At the same time, high concentration in the banking system itself supports banks' pricing power and lending spreads.

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.

Counterparty Risk Rating (CRR)

Moody's Counterparty Risk Ratings are opinions of the ability of entities to honor the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honored. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

Davivienda's CRR is positioned at Baa2/ Prime-2.

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 BCA².

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 issuances³.

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

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

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	4.0%	baa3	← →	baa3	Quality of assets	Collateral and provisioning coverage
Capital						
TCE / RWA	8.6%	b1	← →	b1	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	1.3%	baa2	← →	baa2	Return on assets	
Combined Solvency Score		ba1		ba1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	23.6%	ba1	← →	ba1	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	18.7%	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 Rating	1	0	baa3	1	Baa2	Baa2
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

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
BANCO DAVIVIENDA S.A.	
Outlook	Negative
Counterparty Risk Rating	Baa2/P-2
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 Calculated as provisions to pre provision income
- ² See Moody's Press Release entitled "[Moody's rates Banco Davivienda's proposed senior unsecured notes Baa3; stable outlook](#)" 12 October 2017
- ³ See Moody's Press Release entitled "[Moody's rates Davivienda's proposed subordinated debt issuance](#)," 27 June 2012.

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