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## Research Update:

# Banco Davivienda S.A. 'BBB-/A-3' Ratings Affirmed; Outlook Remains Stable

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## Research Update:

# Banco Davivienda S.A. 'BBB-/A-3' Ratings Affirmed; Outlook Remains Stable

## Overview

- Colombia-based universal bank Banco Davivienda remains as one of the three largest banks in the country, with stable asset quality metrics and sufficient internal capital generation to maintain capitalization levels, despite aggressive loan growth in the past two years.
- In this sense, we forecast our risk-adjusted capital (RAC) ratio for the bank will be between 5.5% and 5.7% for the next 24 months.
- We're affirming our 'BBB-' long- and 'A-3' short-term issuer credit ratings and the 'BBB-' issue-level ratings on the bank.
- The stable outlook on Banco Davivienda reflects our expectation that it will maintain its solid market position in Colombia, while continuing to strengthen its market position in Central America. We also expect the bank to maintain a RAC ratio at moderate levels between 5.5% and 5.7% for the next 24 months. The stable outlook also reflects the ratings on the bank will remain unchanged, given no changes to its 'bbb-' stand-alone credit profile, if we were to lower Colombia's sovereign ratings (foreign currency: BBB/Negative/A-2) by one notch.

## Rating Action

On Feb. 20, 2017, S&P Global Ratings affirmed its long- 'BBB-' and short-term 'A-3' issuer credit ratings on Banco Davivienda S.A. (Davivienda). At the same time, we affirmed our 'BBB-' issue-level rating on Davivienda's \$500 million senior unsecured debt.

## Rationale

Our ratings on Davivienda reflect its solid market share in the Colombian banking system as one of the three largest financial institutions in the country and its geographic diversification in Central America; a projected risk-adjusted capital (RAC) ratio between 5.5% and 5.7% for the next two years as a result of its stable internal capital generation and its manageable asset growth; its highly diversified loan portfolio by economic sectors and clients along with credit losses in line with the banking system average; and a stable funding source based on customer deposits and its handy liquidity needs and short-term obligations. The bank's stand-alone credit profile (SACP) remains at 'bbb-'.

Our bank criteria use our Banking Industry Country Risk Assessment's (BICRA) economic risk and industry risk scores to determine a bank's anchor, the

starting point in assigning an issuer credit rating. The anchor for banks operating mostly in Colombia is 'bb+', which is the case of Banco Davivienda, given that more than 70% of its total loan portfolio is located in Colombia.

Davivienda's business position continue to reflect its large market share in the Colombian financial system as the second-largest bank in terms of total loans and the third largest in terms of deposits. Additionally, our assessment incorporates the bank's business and geographic diversification, as well as the stability of its operating revenue. With a market share of nearly 14% in terms of loans as of September 2016, Davivienda has maintained its solid market position and highly recognized brand in the Colombian banking system. In a span of 10 years with a loan portfolio compound annual growth (CAGR) of 22% compared with domestic banking industry's 15%, Davivienda climbed two positions in terms of total loans outgrowing BBVA Colombia (not rated) and Banco de Bogota (BBB-/Negative/A-3).

Currently, Davivienda has operations in other countries in Central America such as Panama (4%), Costa Rica (7%), Honduras (3%), and El Salvador (7%), all of which account for about 21% of its total loan portfolio. The bank ranks second-largest in terms of total loans, and first-largest in mortgages and consumer loans (with a market share of 24% and 13%, respectively) in Colombia. Operating revenue rose 19% in 2016, reflecting the bank's business stability, despite Colombia's cooling economy. Even though economic growth forecasts have been lowered, we expect Davivienda to capture in the next couple of years the benefits of the implementation of the 4G infrastructure plan and to profit from some improved economic indicators, to maintain its solid position in the Colombian banking industry.

Our capital and earnings assessment is based on our forecasted RAC ratio between 5.5% and 5.7% for the next two years. As of September 2016, the RAC was 5.61% and our projections are based on the following assumptions:

- Colombia's expected GDP growth in 2017 of 2.4% and 2.5% in 2018, according to our latest research update, "Republic of Colombia Sovereign Credit Ratings Affirmed; Outlook Remains Negative," published Jan. 18, 2017.
- Loan portfolio growth of 13% for 2017 and 14% for 2018, based on our expectations. Growth could be higher depending on the Colombian peso's (COP) depreciation pace; however, our expectations are also stable in this regard.
- Net interest margins (NIMs) of around 6.50% in the next two years.
- Core earnings to adjusted assets of 1.5%, in line with the average of the last three fiscal years.
- A 13% increase in operating expenses for 2017 and 2018, reflecting expected capital expenditures in technology (distribution channels, internet portals, and apps).
- Efficiency levels will remain at around 45%.
- Nonperforming assets (NPAs) of around 2.20%, with reserves coverage of 135%, and charge-offs around 1.60%.
- A 30% dividend payout ratio.

Regarding Davivienda's quality of capital, the proportion that goodwill represents in the bank's total adjusted capital (TAC) is 23%, which we consider as high. Davivienda's TAC fully incorporates its preferred shares. Domestic regulator classifies these instruments as Tier 1 and they have deferral capabilities. In this sense, we consider the bank's outstanding preferred shares as intermediate equity content, according to our criteria. As of September 2016, the proportion of preferred shares in the bank's TAC has decreased to 15% from 21% in 2014, and we estimate that it could drop to 13% in 2017. Davivienda's quality of earnings remains satisfactory with profitability metrics consistent with the risk it underwrites (core earnings to adjusted assets was 1.78% as of September 2016) and with a high proportion of net interest income in its revenue mix (80%).

Davivienda's risk position assessment underscores the bank's stable asset quality metrics as well as its loan portfolio diversification by geography, economic sector, and client. As of September 2016, loan portfolio grew 15% year to date and 10% in the past nine months, while the Colombian banking system grew 9.1% for the past 12 months. Davivienda's three-year compound annual growth is 20%, compared with the banking system's 15%. We expect all future growth to be in the bank's traditional area of expertise such as commercial loans and mortgages. In 2016 international operations grew around 8%, and we expect them to grow between 6% and 10%, mainly in Costa Rican and Panamanian markets. We believe Davivienda's loan portfolio is diversified by economic sectors; commercial loans (53%), followed by consumer loans (25%), which includes credit cards auto and personal loans, and mortgages (21%). The bank also exhibits good risk diversification in terms of single-name exposures. As of September 2016, top-20 group exposures represented 10% of the total loan portfolio, and only 0.91x TAC. Foreign-currency goodwill on Davivienda's balance sheet could be a potential risk, which isn't capture in our RAC ratio; if COP depreciates more than expected, our TAC estimate could be affected and therefore our capital indicator. However, our base-case scenario assumes that COP and the bank's goodwill generation will remain relatively stable in the next two years. On the other hand, payroll loans account for about 38% of Davivienda's total consumer loans, which has helped to maintain manageable credit losses and stable asset quality metrics. NPAs (nonperforming loans and foreclosed assets) represented 2.13% of the total loan portfolio as of September 2016. Despite current economic challenges in Colombia, we believe this ratio will remain at around 2.20% in the next two years given the bank's solid underwriting standards.

Banco Davivienda's funding structure continues to rely on customer deposits that represented 76% as of September 2016. Davivienda's funding mix is similar to that of the largest banks in the country and its more direct peers. Around 75% of its consolidated deposits are in Colombia, and the remaining 25% in the international subsidiaries. Similar to the banking system in Colombia, the proportion of retail deposits at Davivienda remains low compared with those of regional banks. As of September 2016, 70% of Davivienda's total deposits were wholesale deposits and 30% retail. Interbank loans, bond issuances, subordinated debt, and repurchase agreements complement Davivienda's funding structure. We don't expect significant changes in the bank's funding mix for

the next two years.

Our liquidity assessment reflects our broad liquid assets to short-term wholesale funding ratio of 1.92x as of September 2016, with an average of 4.1x for the past three fiscal years. Our assessment also incorporates a manageable debt maturity profile that results in low refinancing risk for the next two years. These include the bank's senior unsecured debt of up to \$500 million due 2018 that Davivienda is planning to refinance. For the next two years, we expect the bank to maintain its current liquidity, given manageable refinancing risk and our expectation that the bank's large deposit base will keep expanding.

We currently consider that Davivienda has high systemic importance and that the Colombian government is supportive towards its financial system. Our highly systemic importance assessment is based on Davivienda's status as the third-largest bank in terms of deposits and the second-largest in terms of loans, and its brand recognition. This results in a moderately high likelihood of extraordinary government support. However, the combination of Davivienda's SACP of 'bbb-' and 'BBB+' local currency rating on Colombia doesn't result in any uplift for Davivienda's credit rating.

The bank's ultimate parent is Grupo Bolivar which is a family-owned firm. Therefore, the group credit profile is equal to the bank's issuer credit rating (ICR) which is 'BBB-'.

## Outlook

The stable outlook on Davivienda reflects our expectation that it will maintain its solid market position in Colombia as one of the three largest financial conglomerates in the country, while continuing to strengthen its market position in Central America. The stable outlook also reflects that the ratings on the bank will remain unchanged, given the current SACP of 'bbb-' if we were to lower Colombia's sovereign ratings by one notch. We believe that, despite the economic challenges in the region, Davivienda's asset quality metrics and its capitalization levels will remain stable over the next 24 months, with NPAs of around 2.20% and a projected RAC ratio between 5.5% and 5.7%. The bank's diversified business activities, prudent underwriting standards, and stable internal capital generation will support these metrics.

### Downside scenario

If we were to revise Davivienda's SACP downward by two notches, we could downgrade the bank. However, we believe this is highly unlikely in the next 24 months, given the bank's resilience in terms of business stability and diversification of business activities, with a stable dividend payout ratio and internal capital generation.

### Upside scenario

We don't expect an upgrade in the next two years. Despite Davivienda's moderately high likelihood of government support--which reflects the bank's

high systemic importance and the Colombian government's tendency to support private-sector commercial banks--we don't include any notches of support to the ratings.

## Ratings Score Snapshot

Issuer Credit Rating	BBB-/Stable/A-3
SACP	bbb-
Anchor	bb+
Business Position	Strong (+1)
Capital and Earnings	Moderate (0)
Risk Position	Adequate (0)
Funding and liquidity	Average and Adequate (0)
Support	0
GRE Support	0
Group Support	0
Government Support	0
Additional Factors	0

## Related Criteria

- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 09, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 09, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 06, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

## Ratings List

Ratings Affirmed

Banco Davivienda S.A.	
Counterparty Credit Rating	BBB-/Stable/A-3

Banco Davivienda S.A.

Senior Unsecured

BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com) and at [www.spcapitaliq.com](http://www.spcapitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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