MOODY'S INVESTORS SERVICE

CREDIT OPINION
27 December 2019

Update

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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.

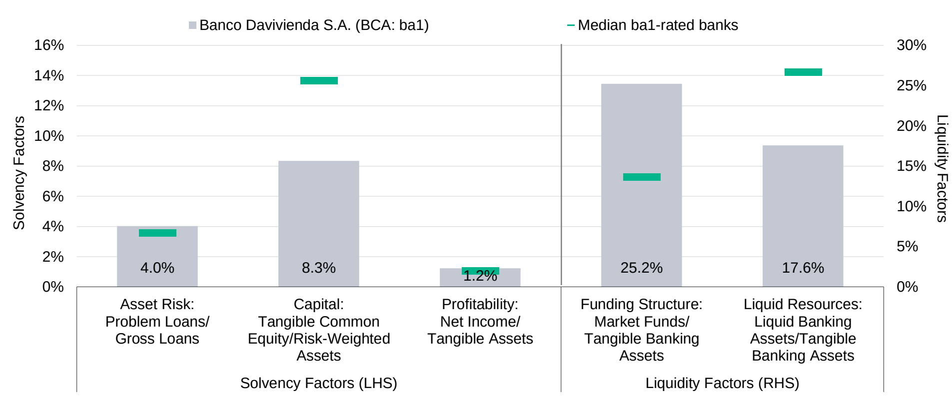
Update to credit analysis

Summary

The Baa3 bank deposits and senior unsecured debt ratings for Banco Davivienda S.A. (Davivienda) incorporate a standalone Baseline Credit Assessment (BCA) of ba1, which reflects the bank's deterioration in its asset risk and profitability metrics in recent years. While problem loans (measured as +90 days problem loans) rose to 3.81% of gross loans as of September 2019, from 2.9% two years earlier as of September 2017, profitability decreased in the same period to 1.2% from 1.3% in the first 9 months of each year on annualized basis, due to higher credit costs.

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



Problem Loans measured as Stage 3 Loans under IFRS. +90 days Problem Loans / Gross Loans = 3.81%
Source: Moody's Financial Metric

Credit challenges

» Credit costs will continue to impact profitability

» Capitalization will remain moderate

Credit strengths

» Good access to core funding and stable liquidity

» Asset quality to improve

Outlook

Davivienda's ratings have a negative outlook, reflecting the deterioration of the bank's asset risk and higher credit costs in recent periods.

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

Davivenda'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]

	09-19[2]	12-18[2]	12-17[2]	12-16[2]	12-15[2]	CAGR/Avg.[3]
Total Assets (COP Billion)	121,027.7	110,723.9	100,771.3	93,548.0	83,718.3	10.3[4]
Total Assets (USD Million)	34,793.5	34,095.1	33,764.9	31,161.9	26,372.1	7.7[4]
Tangible Common Equity (COP Billion)	8,847.5	8,207.8	7,312.7	6,467.7	5,170.1	15.4[4]
Tangible Common Equity (USD Million)	2,543.5	2,527.4	2,450.2	2,154.5	1,628.6	12.6[4]
Problem Loans / Gross Loans (%)	4.0	3.9	2.8	1.9	1.6	2.8[5]
Tangible Common Equity / Risk Weighted Assets (%)	8.3	8.5	8.3	7.7	7.1	8.0[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	29.0	29.0	22.4	17.1	14.6	22.4[5]
Net Interest Margin (%)	5.9	5.8	5.8	5.8	5.8	5.8[5]
PPI / Average RWA (%)	4.4	4.3	4.3	4.5	4.2	4.4[6]
Net Income / Tangible Assets (%)	1.2	1.3	1.3	1.9	1.5	1.4[5]
Cost / Income Ratio (%)	44.4	46.2	46.2	45.1	47.8	46.0[5]
Market Funds / Tangible Banking Assets (%)	24.0	25.2	23.6	22.8	23.8	23.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	16.4	17.6	18.7	17.3	18.8	17.8[5]
Gross Loans / Due to Customers (%)	128.4	128.4	123.5	122.3	121.3	124.8[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 Investors Service; Company Filings

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 September 2019, it was the country's second-largest financial entity in terms of gross loans (with a market share of 15.2% only considering Colombia's operations), and reported total consolidated assets of COP121 trillion ($34.8 billion).

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 58.4% of its total share capital as of September 2019.

Detailed credit considerations

Asset quality to improve in 2019

Our negative adjustment in asset risk captures the bank's concentration in particular large credits related to government projects and suppliers. The bank still holds non performing credits granted to Electrificadora del Caribe S.A. E.S.P. (Electricaribe), and to mass transportation systems in different cities of Colombia. 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. We also note that the exposure to Concesionaria Ruta del Sol S.A.S. II (CRDS II) past due is not considered as PDL because a regulatory disposition. If it were added that could increase PDLs.

Non performing loans, measured as Stage 3 Loans under IFRS, increased to 4.02% in September 2019, in line with YE2018 metric. +90 days Problem Loans to Gross Loans increased to 3.81% as of 3Q2019 from 2017's 2.76%.

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 8.4% September 2019, down from 8.6% 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.

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, as of September 2019 Davivienda's basic capital ratio of 8.2% is higher than the 4.5% minimum, while the 11.2% 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 already provisioned 100% of Electricaribe's exposure but provisions for mass transportation systems and CRDS II at 48% and 79% as of September 2019. 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 2020. According to management projection the reform will increase effective tax rate to 24-26%.

Access to core funding and reduced loan growth contains the need to raise market funds

The ba2 score for funding structure incorporates the bank's moderate reliance on market funds, representing 24% 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 remain stable at around 120% for the last 4 years, 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 16.4% as September 2019, 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 79% 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.

ESG considerations

Davivienda's exposure to environmental risks is low, consistent with our general assessment for the global banking sector. See our Environmental risk heat maps for further information.

Overall, we believe banks face moderate social risks. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which are partly mitigated by sizable technology investments and banks’ long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct represent a further social risk. Social trends are also relevant in a number of areas such as shifting customer preferences toward digital banking services increasing information technology cost, aging population concerns in several countries affecting demand for financial services or socially driven policy agendas translating into regulations that affect banks’ revenue base. See our Social risk heat map for further information.

Governance is highly relevant for Davivienda, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank’s credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for Davivienda, we do not have any particular governance concerns. The bank has not shown any governance shortfall in recent years and benefits from a strong risk management framework. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

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 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 5.875%) reflects one notch of subordination from Davivienda's ba1 standalone BCA, in line with Moody's standard notching practices for plain vanilla subordinated debt 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.

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%	ba1	←→	ba1	Sector concentration	Loan growth	
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel II)	8.3%	b1	←→	b1	Risk-weighted capitalisation		
Profitability							
Net Income / Tangible Assets	1.2%	baa3	←→	baa1	Expected trend		
Combined Solvency Score		ba2		ba1			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	25.2%	ba2	↑	ba2	Extent of market funding reliance		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	17.6%	ba2	←→	ba2	Stock of liquid assets		
Combined Liquidity Score		ba2		ba2			
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			
BCA Scorecard-indicated Outcome - 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 Investors Service

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 See Moody's Press Release entitled "Moody's rates Banco Davivienda's proposed senior unsecured notes Baa3; stable outlook" 12 October 2017

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

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