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Research Update:

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

Primary Credit Analyst:
Jesus S Sotomayor, Mexico City (52) 55-5081-4486; jesus.sotomayor@spglobal.com

Secondary Contact:
Alfredo E Calvo, Mexico City (52) 55-5081-4436; alfredo.calvo@spglobal.com

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Research Update:

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

Overview

- Banco Davivienda remains among the three largest banks in Colombia terms of loans and deposits on a consolidated basis, which supports its sound business stability despite economic challenges in the region.
- We're affirming our 'BBB-' long- and 'A-3' short-term issuer credit ratings (ICRs) on the bank.
- The stable outlook on Banco Davivienda reflects our expectation that it will maintain its solid market position in Colombia. We believe that, despite the economic challenges in the Colombia, the bank's asset quality metrics and capitalization levels will remain stable for the next 24 months, with nonperforming assets (NPAs) around 3% and a projected risk-adjusted capital (RAC) ratio between 5.5% and 6.0%.

Rating Action

On Jan. 31, 2018, S&P Global Ratings affirmed its 'BBB-' long- and 'A-3' short-term ICRs on Banco Davivienda S.A. The outlook remains stable.

Rationale

Davivienda's business position continues to reflect the bank's large market share in Colombia and its diversified business operations in terms of geography and economic sector. Our capital and earnings assessment reflects our forecasted RAC ratio above 5% thanks to the bank's robust internal capital generation and manageable loan portfolio growth rates. In terms of risk position, the bank maintained its metrics in line with the industry norm and competitors in the region with same economic risk. As of September 2017, Davivienda's NPAs were 3.04%, 94% of which the reserves covered, and charge-offs at 1.88%. The bank's funding continues to benefit from a large and stable deposit base, with sufficient liquidity sources to meet upcoming financial obligations. Davivienda's stand-alone credit profile (SACP) is 'bbb-'.

Our bank criteria use our banking industry country risk assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for Davivienda is 'bb+', reflecting the weighted average economic risk of '7', given the countries in which the bank has its major loan portfolio exposures--Colombia (around 75%), El Salvador (8%), Costa Rica (8%), Panama (5%), and Honduras (4%). The industry risk score for Colombian banks is '5' with a stable trend (see "Banking Industry Country Risk Assessment: Colombia," published Sept. 14, 2017).

Davivienda's significant market share in Colombia--almost in all of the bank's products--and its business and geographic diversification in Central America support the lender's business position. With a market share of nearly 15% in terms of loans as of September 2017, Davivienda has maintained its solid market position and its highly recognized brand in the Colombian banking system. Currently, the bank ranks second in the country in terms of total loans (first in mortgages and second in consumer loans with a market share of 24% and 14%, respectively) after its growth outpaced those of BBVA Colombia (not rated) and Banco de Bogotá (BB+/Stable/B) in recent years. This, along with the faster depositor growth than those of main domestic competitors, occurred despite Colombia's cooling economy during 2017. Although Colombian banks posted a lower net income in 2017 mainly due to higher loan loss reserves, Davivienda has exhibited operating revenue stability during the past three years, reflected in a compound annual growth rate (CAGR) of 6.9% (loan loss reserves, which are the main reason for lower income, aren't included in our metric for operating revenues). In terms of geographical diversification, the bank's exposure to Central America hasn't significantly changed in the past year, representing around 25% of Davivienda's consolidated loan portfolio as of September 2017. We believe that the share of domestic loans in Davivienda's total loans will remain stable at around 75%. We believe its geographic diversification adds resilience to the bank's business position in the event of adverse conditions in the Colombian economy, as seen during the last year.

We're maintaining our capital and earnings assessment of Davivienda, based on our forecasted RAC ratio between 5.5% and 6.0% for the next two years. We expect the bank's healthy internal capital generation, along with a stable dividend payout ratio, to compensate for the growth in risk-weighted assets.

Our forecasted RAC ratio takes into account our base-case scenario assumptions, which include:

- Colombia's expected GDP growth in 2018 of 2.4% and 2.5% in 2019, according to our latest research update published in December 2017;
- Loan portfolio growth of 9.5% for 2018 and 2019, on average;
- Net interest margins around 6.40% over the next two years;
- Core earnings to adjusted assets of 1.3%;
- Efficiency levels will remain around 46%;
- NPAs around 3%, with reserves coverage of 100%, and charge-offs around 2%;
- A 30% dividend payout ratio; and
- Our base-case scenario does not consider acquisitions in 2018 and 2019.

As of September 2017, net interest income represented 80% of Davivienda's total operating revenue, while trading gains have represents less than 3% for the past three years. Additionally, the bank's profitability metrics remained in line with those of its main peers in Colombia and the region, despite the sluggish economy in the country. Core earnings to adjusted assets was 1.27% as of September 2017 with a three-year average of 1.80%, in line with the 1.31% of the Colombian banking system as of the same date.

Davivienda's risk position is based on its loan portfolio diversification in terms of economic sector and creditors, and our expectations for adequate asset quality performance for the next two years, despite a projected and historically higher loan growth rates than the industry average and slow economy in the country. Davivienda's loan portfolio growth as of September 2017, was 9.2% (with consolidated figures) for the rolling 12 months, while the Colombian banking system grew around 6%. The bank has been able to maintain asset quality metrics in line with those of the industry, because the majority of its loan growth has been in sectors where Davivienda has historically participated. The bank exhibits adequate risk diversification in terms of sector and single-name exposures. As of September 2017, top-20 group exposures represented 11% of the total loans, and only 1.0x of its total adjusted capital (TAC). The banks three main lending sectors are commercial loans (51%); followed by consumer loans (26%), which include credit cards, and auto, and personal loans; and mortgages (22%). NPAs (nonperforming loans [NPLs] and foreclosed assets) represented 3.04% of the total loans as of September 2017, higher than 2.13% in the same period last year. We project NPAs to be around 3% for the next two years, on average, reflecting subpar economic growth in the country and lower projected loan growth than in previous years. Despite asset quality deterioration, Davivienda's metrics have remained in line with those of the banking system and its main peers.

The funding assessment of Davivienda reflects its funding structure that's mainly composed of stable deposits. Current and saving deposits--10% and 28%, respectively, of total deposits--make up the rest. Deposits account for 73% of Davivienda's total funding structure as of September 2017. The rest of the funding base is comprised of bond issuances (13%), interbank loans (11%), and repos (3%), including subordinated debt. This funding mix has remained stable during the past few years, and we don't expect to change significantly in the coming years based on the bank's profile and strategy. Davivienda's funding assessment is also supported by its long-term funding sources, resulting in a stable funding ratio (SFR) of 100.7% as of September 2017 with a three-year average of 105.6%, which is in line with those of its main Colombian peers. Given our expected stable funding needs and funding structure for the next two years, we expect SFR to remain above 100%.

The bank's broad liquid assets to short-term wholesale funding was 1.4x as of September 2017. The maturity profile of Davivienda's market debt isn't a concern in our opinion, and the refinancing risk has remained limited, as seen in the bank's international bond issuance in October to cover the 2018 maturities of the senior dollar-denominated bond and leverage future growth in order to fund it. We expect the broad liquid assets to short-term wholesale funding to be above 1.8x for the next two years, based on our expectation that the bank won't rely significantly on short-term market debt and the maturity profile will be extended once the senior dollar-denominated bond is repaid.

Outlook

The stable outlook for the next two years 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 and business diversification. We believe that, despite Colombia's cooling economy, the bank's asset quality metrics and capitalization levels will remain stable for the next 24 months, with NPAs around 3% and a projected RAC ratio between 5.5% and 6.0%. Davivienda will support these metrics through its diversified business activities, prudent underwriting standards, and stable internal capital generation.

Downside scenario

We could lower the ratings if the bank's RAC ratio drops below 5%. This could happen amid higher-than-expected loan growth rates, weakening asset quality that could pressure internal capital generation capacity, or higher-than-expected dividend payout ratio that could weigh on the bank's capital base. We could lower the ratings also if asset quality metrics weaken below the industry norm and of main competitors in the region with same economic risk.

Upside scenario

We don't expect significant changes in the bank's business or in its financial profile for the next 24 months. We believe there's a low likelihood of an upgrade. The sovereign ratings on Colombia limit those on Davivienda, given its large exposure in the country (75%), so we don't believe that the bank would pass our sovereign stress test in the event of sovereign distress.

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 - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- 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
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

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

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 for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.