

**Credit Opinion: Banco Davivienda S.A.**

Global Credit Research - 16 Jun 2015

Colombia

**Ratings**

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Baa3/P-3
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Senior Unsecured	Baa3
Subordinate	Ba2

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**Key Indicators**

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

	[2]12-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (COP billion)	67,470.6	56,374.5	47,121.9	36,657.9	29,609.9	[3]22.9
Total Assets (USD million)	28,391.0	29,179.4	26,667.7	18,910.4	15,421.8	[3]16.5
Tangible Common Equity (COP billion)	4,603.0	3,706.2	3,070.7	3,098.7	1,854.7	[3]25.5
Tangible Common Equity (USD million)	1,936.9	1,918.4	1,737.8	1,598.5	966.0	[3]19.0
Problem Loans / Gross Loans (%)	1.6	1.6	1.8	1.6	1.5	[4]1.6
Tangible Common Equity / Risk Weighted Assets (%)	7.7	7.6	7.2	9.0	6.2	[5]7.5
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	12.2	12.4	13.4	9.6	11.0	[4]11.7
Net Interest Margin (%)	6.0	6.2	7.4	6.5	6.5	[4]6.5
PPI / Average RWA (%)	4.2	4.0	4.7	4.5	4.1	[5]4.3
Net Income / Tangible Assets (%)	1.6	1.6	1.5	1.8	2.0	[4]1.7
Cost / Income Ratio (%)	52.4	55.4	54.2	53.3	57.5	[4]54.6
Market Funds / Tangible Banking Assets (%)	17.0	16.1	16.8	18.4	16.7	[4]17.0
Liquid Banking Assets / Tangible Banking Assets (%)	18.9	20.6	21.9	22.7	21.2	[4]21.0
Gross Loans / Total Deposits (%)	103.8	101.9	100.6	101.0	100.9	[4]101.6

Source: Moody's

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

**Opinion**

## **SUMMARY RATING RATIONALE**

On 10 June 2015, Moody's affirmed Banco Davivienda S.A.'s ba1 baseline credit assessment (BCA) and ba1 Adjusted BCA 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. The bank's long-term foreign currency subordinate debt rating was affirmed at Ba2, one notch below Davivienda's ba1 BCA, in line with Moody's notching practices for these types of debt instruments.

Moody's also affirmed Davivienda's 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 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.

On that same date, Moody's assigned 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.

### **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 March 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 December 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.

### **Rating Drivers**

Ample profitability has not kept pace of inorganic and organic growth

Good asset quality and reserve coverage

Aggressive capitalization

Good access to core funding

### **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.

## DETAILED RATING CONSIDERATIONS

### AMPLE PROFITABILITY HAS NOT KEPT PACE OF INORGANIC AND ORGANIC GROWTH

Davivienda's long-term profitability remains high and stable with net income to tangible assets of 1.6% as of year-end 2014, in line with 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 ample margins in the short-term.

Davivienda's net income during 2014 increased 24.6% to COP1 trillion as a result of 14.2% higher net interest income, in line with high 23.8% loan growth, and controls in credit cost, which grew at 2.4% and operating costs, which grew at 8.9%, as well as an extraordinary boost from gains related to the exchange rate.

The bank's net interest margin remains ample but follows a downward trend to 6.0% through year-end 2014, from 6.2% during 2013 and 7.4% during 2012, mainly as a result of high competition.

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.

During the first quarter of 2015, Davivienda's net income remained largely flat, reaching COP302 billion, from March 2014's COP299 billion, despite a 20.2% expansion in net interest income and a subdued 13.3% increase in credit costs versus a somewhat moderate 18.7% increase in operating costs, largely related to a much higher tax cost of 27.0% pretax income, versus March 2014's 20.6%.

### 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 year-end 2014, 90+ days past due loans (problem loans) represented 1.6% of gross loans, coupled by an ample LLR coverage of problem loans of 247.0%. 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 (51.7%), consumer (26.8%) and mortgages (21.5%), as of March 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. During the first quarter of 2015, the problem loan ratio deteriorated to 1.9%.

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 high corporate governance standards. Loans to related parties composed a low 5.5% of Tier 1 capital, as of year-end 2014.

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.

### **AGGRESSIVE CAPITALIZATION**

Davivienda reported a low tangible common equity (TCE, common stock plus retained earnings minus goodwill) to risk weighted assets of 7.7% as of year-end 2014. Nevertheless, through April 2015, Moody's estimates the bank's capitalization to increase to about 9.5%, based on a substantial dividend in the form of stocks and an increase in legal reserves. If the bank is able to maintain this level of capitalization stable, upward ratings pressure could ensue.

The bank's goodwill is mainly related to the acquisition of Bancafé/Granbanco. Moody's adjusts RWAs by risk-weighting 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 64.3% of total assets as of March 2015.

As of March 2015, Davivienda was the third largest bank in Colombia, with an important market share of 12.7% of loans and 11.6% of deposits. The bank has presence in six countries and 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 2104.

As a result of this, the bank's market funding levels are somewhat low market funding at 17.0% of tangible banking assets leading as of year-end 2014. The bank's loan to deposit ratios has nevertheless deteriorated to 115.6%, as of March 2015, as loans expanded at 25.4% year-over-year versus deposit growth of 18.2%.

Nevertheless, the bank holds low levels of liquid banking assets at 18.9% of tangible banking assets as of year-end 2014.

### **Notching Considerations**

In the absence of a bail-in resolution regime framework in Colombia, as per the "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%).

On 22 January 2013, Moody's assigned 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.

<b>Macro Factors</b>	
<b>Weighted Macro Profile</b>	<b>Moderate</b>

<b>Financial Profile</b>						
<b>Factor</b>	<b>Historic Ratio</b>	<b>Macro Adjusted Score</b>	<b>Credit Trend</b>	<b>Assigned Score</b>	<b>Key driver #1</b>	<b>Key driver #2</b>
<b>Solvency</b>						
<b>Asset Risk</b>						
<i>Problem Loans / Gross Loans</i>	1.7%	baa1	← →	baa2	Loan growth	
<b>Capital</b>						
<i>TCE / RWA</i>	7.7%	b3	↑ ↑	b2	Expected trend	
<b>Profitability</b>						
<i>Net Income / Tangible Assets</i>	1.6%	baa1	← →	baa1	Earnings quality	
<b>Combined Solvency Score</b>		ba1		ba1		

<b>Liquidity</b>						
<b>Funding Structure</b>						
<i>Market Funds / Tangible Banking Assets</i>	17.0%	baa3	← →	baa3	Deposit quality	
<b>Liquid Resources</b>						
<i>Liquid Banking Assets / Tangible Banking Assets</i>	18.9%	ba2	← →	ba2	Quality of liquid assets	
<b>Combined Liquidity Score</b>		ba1		ba1		

<b>Financial Profile</b>
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<b>ba1</b>
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<b>Qualitative Adjustments</b>
Business Diversification
Opacity and Complexity
Corporate Behavior
<b>Total Qualitative Adjustments</b>

<b>Adjustment</b>
0
0
0
<b>0</b>

Sovereign or Affiliate constraint
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Baa2
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Scorecard Calculated BCA range
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baa3 - ba2
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<b>Assigned BCA</b>
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<b>ba1</b>
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Affiliate Support notching
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<b>0</b>
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<b>Adjusted BCA</b>
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<b>ba1</b>
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Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	0	0	ba1	0	Baa3	Baa3
Senior unsecured bank debt	0	0	ba1	0		Baa3
Dated subordinated bank debt	-1	0	ba2	0		Ba2

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