

RatingsDirect®

Research Update:

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

Primary Credit Analyst:

Alfredo E Calvo, Mexico City (52) 55-5081-4436; alfredo.calvo@standardandpoors.com

Secondary Contact:

Javier Marquez, Mexico City; javier.marquez@standardandpoors.com

Table Of Contents

Overview

Rating Action

Rationale

Outlook

Ratings Score Snapshot

Related Criteria And Research

Ratings List

Research Update:

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

Overview

- Colombia-based bank Davivienda is a leading participant in the Colombian consumer segment and continues to improve its geographic diversification. The bank has moderate risk-adjusted capitalization, and has maintained adequate asset quality and profitability metrics. Davivienda has "high systemic" importance within the Colombian banking system, in our view.
- We are affirming our 'BBB-' long-term and 'A-3' short-term ratings on Davivienda.
- The stable outlook reflects our expectation that Davivienda will maintain its significant market position in Colombia and continue its prudent growth strategy in Central America. Its conservative underwriting standards should continue to support adequate asset quality metrics.

Rating Action

On April 2, 2014, Standard & Poor's Ratings Services affirmed its long-term 'BBB-' and short-term 'A-3' issuer credit ratings on Banco Davivienda S.A. (Davivienda). At the same time, we affirmed our 'BBB-' senior unsecured debt rating on Davivienda. The outlook remains stable.

Rationale

The ratings on Davivienda reflect our view of its "strong" (as our criteria define the term) business position, "moderate" capital and earnings, "adequate" risk position, "average" funding, and "adequate" liquidity. Davivienda's stand-alone credit profile (SACP) remains at 'bbb-'.

Under our bank criteria, we 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. Our anchor for Davivienda is 'bbb-', which reflects our view of the weighted-average economic risk in the countries to which the bank is exposed through its loans--Colombia (representing more than 80% of total loans), El Salvador, Costa Rica, Panama, and Honduras. We score BICRAs on a scale of '1' to '10', ranging from the lowest risk banking systems (group '1') to the highest risk (group '10'). Our weighted economic risk score for these countries is '6.3'. Given that majority of Davivienda's exposure is, and will remain, in Colombia, the bank's anchor is based on the country's economic risk score of '6' and an industry risk score of '5'.

Colombia's economic risk reflects the country's low-income levels, which constrain its economic resilience to some extent, and reflect our "high risk" assessment for credit risk in the economy, as households have lower capacity to take out credit lines and are more vulnerable to economic downturns. On the other hand, Colombia has low inflation, moderate fiscal and current account deficits, a floating exchange rate, and a strong political consensus on key economic policies. These factors should maintain policy stability and economic resilience in the coming years. Colombia still shows manageable economic imbalances--in our view, relatively fast credit expansion and rising housing prices pose an "intermediate risk" for the financial system. Still, the country's banking sector has sound asset quality and good underwriting standards, especially in the mortgage market.

Our industry risk score of '5' reflects no significant distortions in the financial system, adequate industry stability, and a satisfactory deposit base that has remained fairly stable even during periods of market turmoil. On the other hand, we believe there is room for improvement in Colombia's regulatory framework and track record, in particular with regard to capitalization rules. On the positive side, transparency in the financial system is very good and compares favorably with many of its peers in the region.

We continue to assess Davivienda's business position as "strong" within the Colombian banking system based on the strength of the bank's presence in Colombia in its core businesses, its well-diversified business mix, and its increasing footprint in Central America, which has boosted the bank's geographic diversification. As of Dec. 31, 2013, Davivienda was the third-largest commercial bank in Colombia, holding 12% of the market's total loans. Davivienda's consumer segment market share is 13% and mortgages represent 17%. Davivienda also holds a significant market position in the Central American countries where it has presence--in particular in El Salvador, Honduras and Costa Rica; 16% of Davivienda's net income came from its Central American subsidiaries at year-end 2013. We believe Davivienda's loan portfolio will grow by about 16% during the next two years, and we expect the bank to maintain its strong presence, expanding its customer base through synergies with its recently acquired brokerage business line, Corredores Asociados, and by its relatively new banking product, Daviplata, which could bring new customers into the banking system.

Davivienda's business activities diversification, reflected in contributions to its overall revenue base from its varied business lines throughout Colombia and Central America, also support Davivienda's "strong" business position. As of Dec. 31, 2013, the bank's loan portfolio is mainly composed of commercial and corporate loans (51%), while consumer loans and mortgages represent 27% and 22%, respectively. We expect commercial and corporate loans and mortgages to grow at a faster pace with respect to consumer loans during 2014 and 2015, so we do not expect significant changes in Davivienda's loan composition. In addition, Davivienda's loan portfolio is still concentrated in Colombia, since around 80% of the bank's commercial loans--its largest business line--are located there. The remaining 20% of the bank's commercial loans are in El Salvador (7%), Panamá (6%), Costa Rica (4%), and Honduras (3%). We do not

expect significant changes in this regard during the next two years.

Our "moderate" assessment of Davivienda's capital and earnings is based on our forecasted risk-adjusted capital (RAC) ratio, which we expect to be 6% to 6.5% over the next two years. This ratio was 6.3% at year-end 2013. Our financial forecasts are based on our main base-case scenario assumptions for 2014 and 2015:

- Colombia's GDP growth of about 4% in 2014 and 4.3% in 2015;
- Loan portfolio growth at about 16%;
- Stable profitability levels, with net interest margins around 6.9%, return on assets (ROA) of about 1.5%, and efficiency levels still below 50%.
- Davivienda's credit loss provisions should represent around 30% of its operating revenues;
- Nonperforming assets (NPAs; NPAs include foreclosed assets) will likely be at about 2%, fully covered by reserves, and net charge-offs to total loans below 1% ;
- We expect Davivienda's dividend policy to remain stable, with a payout ratio of about 30%. Davivienda's goodwill should remain relatively stable during 2014 and 2015.

Davivienda's total adjusted capital (TAC) fully incorporates its preferred shares (Colombian peso [COP] 1.135 trillion, representing 23% of its TAC as of Dec. 31, 2013), which classify as "intermediate equity content: instruments. (See our criteria "Bank Hybrid Capital Methodology and Assumptions," published Nov. 1, 2011.) This and Davivienda's adequate earnings capacity somewhat offset the bank's significant goodwill due to historic inorganic growth. Given the substantial amount of hybrid capital instruments within its TAC, we view Davivienda's quality of capital as moderate. However, we view the bank's quality of earnings as adequate thanks to its adequate and stable profitability metrics, and to the low participation of trading revenues within the bank's operating revenues.

Davivienda's risk position is "adequate," in our view. Its relatively low credit losses and adequate risk diversification in terms of individual debtors and sectors support our assessment. The bank is slowing the pace of its growth: its loan portfolio grew by 19% in 2013, following more than 28% growth in 2012, due to the natural organic growth in Colombia and the acquisition of its Central American subsidiaries. The bank's loan portfolio grew 23% in 2011. We expect the bank to continue to temper its growth, which may increase by 16% annually in the next two years. We do not expect significant changes in the bank's loan composition; however, we expect mortgage loans participation in the loan portfolio to rise as it represents a key driver in Davivienda's growth strategy. Corporate and commercial loans will likely represent Davivienda's largest business line.

In our opinion, Davivienda's adequate risk diversification continues to represent a strength. As of Dec. 31, 2013, the bank's top 25 customers represented 11% of its total loans and 74% of its capital. These ratios are

superior to the bank's peers in the region. There are no risk concentrations in terms of economic sectors, in our view, due to the strong participations of consumer and mortgage loans within the bank's loan portfolio, and Davivienda's exposure to related parties is limited; it represented less than 1% of total loans as of Dec. 31, 2013. Davivienda's adequate credit loss experience also represents a strength, in our view. Credit recoveries support Davivienda's relatively low net credit losses, which we estimate at less than 1% during the next two years. The consumer loan portfolio is responsible for about 90% of the bank's charge-offs. The bank's NPAs represented 1.8% of total loans at year-end 2013 fully covered by reserves 2.35x, and we expect this ratio to remain at about 2.0% and fully covered. The industry's NPAs represented 2.0% of total loans and fully covered 2.56x.

Davivienda's funding remains "average" and liquidity "adequate." Our opinion is supported by the bank's funding composition; the majority of its funding sources are customer deposits. As of Dec. 31, 2013, total deposits represented 75% of its total funding base. The remaining funding sources are interbank credit facilities (8%), repos (3%), senior unsecured bonds (9%), and subordinated debt instruments (5%). We expect this funding structure to remain stable going forward, based on our expectation that customer deposits will continue a positive growth trend that was 20.8% during 2013 with a three year average of 23.4%). Davivienda has access to the securitization market as an alternative source of funding. Davivienda has consistently covered its stable funding needs with its available stable funding by more than 100%. As of Dec. 31, 2013, Davivienda's stable funding ratio was 111.4% with a three-year average of 112%. These levels are very similar to our estimate for the Colombian banking system, which posted a three-year average stable funding ratio of 108.2%. In our opinion, Davivienda does not have deposit concentration since its top 20 depositors represent around 11% of the bank's total deposit base.

In an effort to diversify its funding structure, Davivienda has issued subordinated debt and senior unsecured notes, which supports its loan growth, and improves the match between the duration of its assets to liabilities because the funding is long term. This strategy, and the increasing participation of time deposits within its deposit base, is pressuring Davivienda's net interest margin through higher interest expenses.

Our view of Davivienda's "adequate" liquidity is supported by its manageable refinancing risk and adequate liquidity coverage. The bank's broad liquid assets as of Dec. 31, 2013 were COP10.78 trillion and covered its short-term wholesale funding by 3.17x. The three-year average liquidity ratio was 3.6x. We do not expect any change in Davivienda's liquidity structure in the next 18 to 24 months.

Davivienda is a bank with "high systemic" importance in the system. This reflects the bank's leading position and brand recognition in the country; the bank's market share in terms of retail loans and deposits were 13% and 11%, respectively, as of Dec. 31, 2013. This, and considering the government's tendency to support private-sector commercial banks--which we assess as

"supportive"--results in what we consider a "moderately high" likelihood of government support. However, at this point the issuer credit rating (ICR) on the bank does not receive notches of support from its "high systemic" importance.

Outlook

The stable outlook on Davivienda incorporates our view that its role as an institution with "high systemic" importance within the Colombian banking system will not change. The outlook also reflects our expectation that the bank will maintain its strong presence in Colombia, with stable market shares in the different business lines in which it participates. In addition, we believe our RAC ratio will remain a moderate 6% to 6.5%, credit losses will remain relatively low--with net charge-offs representing less than 1% of total loans in the next two years--and profitability will remain adequate.

Stronger capitalization, reflected in a RAC ratio consistently above 7.0% could lead to an upgrade; however, this is not part of our base-case scenario. Despite Davivienda's "moderately high" likelihood of government support--which reflects the bank's "high systemic" importance and the Colombia government's tendency to support private-sector commercial banks--we do not include any notch of support to the ICR. If we raise the local currency long-term rating on Colombia, we would raise the ratings on Davivienda, reflecting one notch of government support, if its SACP is unchanged.

For a downgrade, we would have to revise Davivienda's SACP downward by two notches. We believe this is highly unlikely in the next 12-18 months given the bank's resilience in terms of business stability and diversification of business activities while maintaining its current 30% dividend payout ratio. In addition, we do not expect the bank's risk position to weaken in the next 12-18 months.

Ratings Score Snapshot

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

Additional Factors

(0)

Related Criteria And Research

Related Criteria

- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Bank Hybrid Capital Methodology and Assumptions, Nov. 1, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology and Assumptions, Dec. 6, 2010

Related Research

- Despite Market Uncertainties, Latin American Banks Have Generally Been Able To Maintain Satisfactory Performance, Jan. 16, 2014
- Credit Conditions: Growth In Latin America Expected To Pick Up In 2014 Amid Continuing Financial Market Volatility, Dec. 13, 2013
- Latin American Banks Lean On Adequate Funding And Liquidity Amid Market Uncertainties, Oct. 16, 2013

Ratings List

Ratings Affirmed

Banco Davivienda S.A.

Counterparty Credit Rating
Senior Unsecured

BBB-/Stable/A-3
BBB-

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.

Copyright © 2014 Standard & Poor's Financial Services LLC, a part of McGraw Hill Financial. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED, OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses, and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgement as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain nonpublic information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.ratingsdirect.com and www.globalcreditportal.com (subscription) and www.spcapitaliq.com (subscription) and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.