MOODY'S INVESTORS SERVICE

Credit Opinion: Banco Davivienda S.A.

Global Credit Research - 12 Dec 2012

Bogota, Colombia

Ratings

Category	Moody's Rating
Outlook	Negative(m)
Bank Deposits	Baa3/P-3
Bank Financial Strength	D+
Baseline Credit Assessment	(ba1)
Adjusted Baseline Credit Assessment	(ba1)
Subordinate	*Ba1

* Placed under review for possible downgrade on November 27, 2012

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Key Indicators

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

	[2]9-12	[2]12-11	[2]12-10	[2]12-09	[2]12-08	Avg.
Total Assets (COP billion)	38,554.8	36,657.9	29,609.9	26,158.9	22,833.3	[3]14.0
Total Assets (USD million)	21,408.7	18,910.4	15,421.8	12,804.2	10,154.7	[3]20.5
Tangible Common Equity (COP billion)	3,243.4	3,098.7	1,865.2	911.0	640.9	[3]50.0
Tangible Common Equity (USD million)	1,801.0	1,598.5	971.4	445.9	285.0	[3]58.5
Net Interest Margin (%)	6.2	6.5	6.5	6.0	6.5	[4]6.3
PPI / Avg RWA (%)	8.5	7.8	8.3	10.0	10.2	[5]9.0
Net Income / Avg RWA (%)	2.1	2.1	2.3	2.2	2.3	[5]2.2
(Market Funds - Liquid Assets) / Total Assets (%)	2.7	-2.1	-1.7	-7.6	-6.8	[4]-3.1
Core Deposits / Average Gross Loans (%)	84.6	94.4	96.4	106.7	111.2	[4]98.7
Tier 1 Ratio (%)	12.1	11.4	9.6	8.4	8.3	[5]10.0
Tangible Common Equity / RWA (%)	9.2	9.3	6.7	4.0	3.3	[5]6.5
Cost / Income Ratio (%)	35.9	40.4	41.6	36.8	52.8	[4]41.5
Problem Loans / Gross Loans (%)	3.3	3.4	3.5	4.2	6.1	[4]4.1
Problem Loans / (Equity + Loan Loss Reserves) (%)	14.6	15.0	16.3	20.1	30.9	[4]19.4

Source: Moody's

[1] All 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

RECENT CREDIT DEVELOPMENTS

On 27 November 2012, Moody's placed Banco Davivienda S.A.'s long term foreign currency subordinated debt rating of Ba1 on review for downgrade as Moody's reassesses systemic support for subordinated debt ratings as discussed in the special comment "Supported Bank Debt Ratings at Risk of Downgrade due to New Approaches to Bank Resolution," published February 2011.

SUMMARY RATING RATIONALE

On 30 January 2012, Moody's affirmed all of Banco Davivienda S.A.'s (Davivienda) ratings and changed the outlook to negative, from stable, following the announcement on 24 January 2012 of the acquisition of HSBC's bank, insurance and financial and service companies in El Salvador, Costa Rica and Honduras (HSBC Central America). The following ratings were affirmed with a negative outlook: D+ standalone financial strength (BFSR) and Baa3/Prime-3 long and short term local and foreign currency deposit ratings. Davivienda's D+ BFSR translates to a standalone credit assessment (BCA) of ba1.

The negative outlook on Davivienda's ratings reflects the sizable acquisition of HSBC Central America, representing 19% of Davivienda's assets at end-September 2012, and the fact that this is the bank's first major cross border investment. By venturing outside of its home market, Davivienda will be exposed to increased credit, market and foreign exchange risks within several developing Central American countries that could have a negative effect on its liquidity and profitability.

The acquired banks' modest profitability, high operating cost structures and still high credit costs will continue to demand close attention by management, particularly with regards to integration and risk management plans for the new entity, and could hurt Davivienda's consolidated earnings. Moody's will monitor the effect on asset quality, if any, of aligning these entities' credit and provisioning policies to those of Davivienda's, considering that respective operating environments are currently less benign than that in Colombia.

Davivienda financed the US$801 million acquisition with the proceeds from its US$500 million subordinated debt issuance (rated Ba1 by Moody's), and on-balance liquidity. For the acquisition, management had originally considered using the proceeds from its preferred share issuance of COP716 billion (US$370 million), completed in December 2011. Davivienda's Tier 1 capital, excluding goodwill, will decrease to levels reported prior to the preferred share issuance, which Moody's considers weak.

The acquisition may challenge the execution of Davivienda's current business strategy in Colombia, where the bank continues to expand and strengthen the corporate lending franchise it acquired from Bancafé (Granbanco). Davivienda also faces tough competition from much larger and more entrenched institutions both within Colombia and in Central America. Nevertheless, the bank has a well established local operation that is focused on consumer and mortgage lending, and which could be successfully implemented in its new Central American franchise.

Davivienda's Baa3 deposit ratings incorporate one notch of uplift from the Ba1 standalone BCA because of Moody's assessment of a high probability of systemic support from the Colombian government in light of the bank's important domestic deposit and lending franchise.

Rating Outlook

All ratings have a negative outlook, except for Davivienda's long term foreign currency subordinated debt rating, which is on review for downgrade.

Rating Drivers

- Franchise Value: Diversified banking franchise supported by significant retail lending operations and good access to core funding

- Risk Positioning: Faces tough competition from much larger financial groups in Colombia and Central America

- Profitability: Profitability has been stable and high and compares well with those of its larger peers

- Asset Quality and Capital Adequacy: Davivienda's good asset quality and reserve coverage support its weak capitalization levels

- Liquidity: Davivienda maintains high holdings of liquid assets and low levels of purely market funding

Recent Events

On 7 December 2012, Davivienda finalized the acquisition of HSBC Central America, with the payment for Banco Davivienda Honduras, S.A. (for USD151 million); the bank paid USD350 million for Banco Davivienda Salvadoreño, S.A. on 30 November 2012 and USD300 million for Banco Davivienda (Costa Rica) S.A. on 23 November 2012. Year-end 2012 is expected to be the first publication of consolidated, audited financial including the three new subsidiaries.

Price to book value for HSBC Central America was about 1.4x, for a goodwill of about USD247 million, versus a Tier 1 capital of USD2.4 billion as of September 2012.

As of September 2012, Davivienda's Tier 1 ratio is 12.1% (10.4% under new norms), and is expected to decrease to 7.5% following the acquisition and the implementation of new capitalization norms in Colombia.

What Could Change the Rating - Down

Based on Davivienda's acquisition announcement, the ratings could come down based on the effects on the bank's earnings, liquidity and asset quality. Moody's will review management's integration and risk management plans for the new entity.

What Could Change the Rating - Up

Upward pressure at this juncture is less likely.

Recent Results

During the first nine months of 2012, net income increased 24.4% to COP540 billion when compared to the same period last year, in line with 13.9% loan growth over year ago and 23.9% growth in income from loans and higher income from investments. Preprovision, pre-tax income (PPI or core earnings)increased to 8.5% of average risk weighted assets (avg RWAs), from 7.8% as of year-end 2011. Net income also increased to 2.0% of avg RWAs, from 1.9%.

During 2011, Davivienda's net income had increased 9% to COP 630 billion for slightly lower return on average assets of 1.9%, versus 2.1% as of year-end 2010, and return on average equity of 15.5%, versus 18.5%. The net interest margin of 6.5% had remained largely stable and loan growth was 22.4%.

Davivienda continues to maintain a low cost infrastructure, with operating costs representing 35.9% of gross operating revenues, as of September 2012, down from 40.4% as of year-end 2011.

September 2012 problem loans (loans classified C, D, or E) reflect a downward trend to 3.3%, from a peak of 6.1% as of year-end 2008. Davivienda's good asset quality ratios are the result of management's tightening lending policies, subsequent deterioration during 2008 and 2009, and a certain amount of write-offs that followed. Loan loss reserves coverage is ample representing 4.8% of gross loans and 145.8% of problem loans as of September 2012.

Davivienda's liquidity ratio [(market funds - liquid assets)/total assets] deteriorated to 2.7% during the first nine months of 2012, from -2.1%, as a result of lower growth levels in deposits of 6.8%. Liquid assets have remained largely stable at 21.1% of total assets.

Unless noted otherwise, consolidated data used in this report is sourced from company reports, Moody's Financial Metrics and Colombia's Superfinanciera.

DETAILED RATING CONSIDERATIONS

Detailed rating considerations for Davivienda's ratings are as follows:

Bank Financial Strength Rating

FRANCHISE VALUE

Davivienda's franchise value is based on its important market shares, Colombian footprint and Moody's assessment of earnings stability given its evenly spread lending book between wholesale and retail operations.

Davivienda is a universal bank that was initially created in 1972 as a savings and mortgage corporation (CAV).

Since 2006, Davivienda has expanded its loan portfolio at a 32% compounded annual growth rate (CAGR) through both organic growth and strategic acquisitions. Davivienda acquired two banks, Bansuperior in 2006, an expert in credit cards and in 2007 Bancafé (Granbanco), which provided corporate banking, a wide branch network and international operations in Panama City and Miami.

As of August 2012, Davivienda was the third largest bank in Colombia, with important market shares (10% in terms of assets) and second in consumer lending (14%), with important market shares in mortgages (12%). The bank also has a considerable prsence in social housing (VIS) with a 27% market share and in credit cards with 18%, as of year-end 2011. The bank has presence in 187 cities and operates through 570 branches in Colombia, one branch in Miami and two agencies in Panama City (Davivienda Internacional Panamá), as of August 2012. The bank also offers its clients fleet financing through Confinanciera (which was merged into the bank in August 2012), trust management through Fiducafé and Fiduciaria Davivienda and brokerage services through Davivalores. The bank's combined earnings from retail banking are high, at 66% of revenues for 2011.

Davivienda has diversified its loan portfolio and transformed from a mortgage oriented bank into a universal bank, wherein 72% of its assets are directed to lending. The bank's lending portfolio is well diversified between consumer (32%), mortgages (16%) and commercial loans (52%), as of September 2012. The bank's portfolio composition is not expected to change dramatically with the acquisition of HSBC Central America, where 47% of the portfolio is in the form of commercial loans, 27% mortgages and 26% consumer loans, as of September 2012.

RISK POSITIONING

Davivienda's acquisition of HSBC Central America is sizable, representing 19% of Davivienda's assets as of September 2012. This acquisition exposes the bank to increased credit, market and foreign exchange risks within several developing Central American market and pressures Davivienda's still consolidating local business.

Davivienda is the largest subsidiary of the Colombian economic conglomerate Grupo Bolívar which controls 55.6% of the bank, as of September 2012. Other major shareholders include Inversiones Cúsezar (17.1%) and the International Finance Corporation (IFC, 3.9%). Also 23.4% of the bank's capital is held by minority shareholders and including those shares that are publicly traded in the Colombian stock exchange.

Despite Davivienda's single-major shareholder (family ownership), Davivienda maintains best practices in corporate governance which are reflected in almost null related party lending. The bank has a well experienced management team and a longstanding relationship with the IFC (initial investment in 1973) which encourages Davivienda's high corporate governance standards.

Davivienda is adequately diversified by industry, wherein its largest exposure, to commercial services, represents 15% of loans.

Granularity is low given the bank's twenty largest exposures, which in all represent 98.4% of Tier 1 capital, as of year-end 2011. Largest exposures are indubitably to the best credits present in the country and in aggregate compare favorably with those of its peers in Latin America. High concentrations, though comparing well with other local and regional peers, are a weakness and expose the bank to potentially rapid asset quality deterioration.

Davivienda's risk and liquidity management are adequate and in line with best practices. Committees provide the Board of Directors with monthly or quarterly information. Credit risk is managed by a governance structure with a clearly defined mandate and delegated authorities, price/market risk is measured daily, interest rate risk is managed on a monthly basis through control models and liquidity stress scenario generated and reported on a weekly basis. Figure of Chief Risk Officer has veto power.

Davivienda has a conservative liquidity risk position. The bank has established adequate mechanisms to address liquidity situations in multiple stress scenarios.

Given that investment securities are mainly composed of government issuances and that Davivienda's main focus is lending, market risk appetite is limited. The unconsolidated VaR at end-August 2012 was COP 160.4 billion, or 3.8% of Tier 1 capital at risk due to market risk events, according to the Superfinanciera.

PROFITABILITY

As most Colombian banks, Davivienda maintains assets and liabilities largely indexed to the central bank's benchmark interest rate and/or the 90-day CD rate (DTF). As such, it is able to report stable and very ample net interest margins of 6.3% (three-year average). Davivienda's income comes mainly from its largely consumer credit portfolio.

PPI and net income versus avg RWAs have been stable and high historically for the bank and compare well with those of its larger peers. PPI has averaged for the past three years at a high 8.7% of avg RWAs, with net income also averaging a high 2.2% of avg RWAs.

Davivienda's profitability is also supported by the bank's good efficiency levels, with operating cost representing a low 43.8% (three-year average) of gross operating revenues.

ASSET QUALITY AND CAPITALIZATION

Davivienda's good asset quality and loan loss reserve coverage support its weak capitalization levels.

Davivienda reports comfortable levels of problem loans, with very ample reserve coverage. On a three-year average basis, problem loans have represented 3.7% of gross loans and 17.1% of shareholders' equity plus loan loss reserves.

Davivienda's good asset quality ratios are the result of management's tightening lending policies, subsequent to deterioration during 2008 and 2009 and a certain amount of write-offs that followed.

Problem loans peaked at 6.1% at end-2008 and have since come down to represent 3.4% at end-2011.

The bank's three year-end average Tier 1 ratio of 9.8% can withstand substantial stress on its portfolio, based on Moody's usual scenario analysis. Capitalization is expected to decrease with new Basel III norms established in Colombia, mainly as a result of the deduction of the goodwill to be incorporated by HSBC subsidiaries.

LIQUIDITY

Moody's preferred liquidity ratio [(market funds - liquid assets)/total assets] seeks to measure the level of use of market funding, and as such the more negative the outcome, the better. The liquidity score also incorporates Davivienda's adequate liquidity management (as explained in the Risk Positioning section of this report).

Davivienda's three year-end average liquidity ratio of -3.8%, is good and underscores the bank's high holdings of liquid assets and low levels of purely market funding (non-deposit funding).

Davivienda maintains high holdings of liquid assets, which have averaged 22.4% of total assets for the last three years. Liquidity is supported by the bank's deposit-based funding.

The bank would have access to alternative liquidity through access to repurchase agreements with Banco de la República before a hypothetical need for asset sales/securitizations. The bank would be able to repo Colombian treasury bills, obligatory investments, and TIPS (mortgage securitizations). Banrepública also offers banks a Transitory Liquidity Support program for repurchasing loans and securities for up to 15% of deposits.

Assigned Rating vs Scorecard Outcome

As a point of reference, Moody's assigns a D+ standalone BFSR to Davivienda, which is two notches below the scorecard-implied rating of C (see table below). Moody's believes the D+ rating reflects Davivienda's high dependence on the domestic macroeconomic and financial environment and market position within Colombia. The Colombian government's local and foreign currency bond rating is Baa3.

Global Local Currency Deposit Rating (Joint Default Analysis)

The local currency deposit rating of Baa3 assigned to Davivienda, is one notch above the bank's standalone BCA of ba1, based on Moody's assessment of a very high level of systemic support for Davivienda given its considerable market shares in deposits and loans and as the third largest bank in the country. Colombia's systemic support indicator of Baa1 is two notches above the debt ratings of the Colombian government.

Foreign Currency Deposit Rating

Davivienda 's Baa3 foreign currency deposit rating are at Colombia's foreign currency ceiling for deposits (Baa3) and as such are unconstrained by it.

Foreign Currency Debt Rating

On 27 June 2012, Moody's assigned a foreign currency debt rating of Ba1 to Davivienda's unsecured subordinated debt in foreign currency of USD500 million with a ten-year maturity (coupon of 5.95%). On 27 November 2012, Moody's placed Davivienda's long term foreign currency subordinated debt rating on review for downgrade as Moody's reassesses systemic support for subordinated debt ratings as discussed in the special comment "Supported Bank Debt Ratings at Risk of Downgrade due to New Approaches to Bank Resolution," published February 2011.

Notching Considerations

As a consequence of the increased probability that losses may be imposed on subordinated debt, Moody's is considering removing the systemic support which currently accounts for one notch of uplift. Upon the conclusion of the review and in line with "Moody's Guidelines for Rating Bank Hybrid Securities and Subordinated Debt", Moody's may position the rating of the subordinated debt issuance of Davivienda one notch below the standalone BCA of ba1.

Rating Factors

Banco Davivienda S.A.

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (70%)						**C-**	
Factor: Franchise Value						**C+**	**Neutral**
Market Share and Sustainability		**x**					
Geographical Diversification				**x**			
Earnings Stability		**x**					
Earnings Diversification [2]							
Factor: Risk Positioning						**C-**	**Neutral**
Corporate Governance [2]				**x**			
- Ownership and Org. Complexity				x			
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management		**x**					
- Risk Management			x				
- Controls	x						
Financial Reporting Transparency		**x**					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
Credit Risk Concentration				**x**			
- Borrower Concentration				x			
- Industry Concentration		x					
Liquidity Management			**x**				
Market Risk Appetite			**x**				
Factor: Operating Environment						**D**	
Economic Stability				**x**			
Integrity and Corruption				**x**			
Legal System				**x**			
Financial Factors (30%)						**B**	
Factor: Profitability						**A**	**Neutral**
PPI / Average RWA - Basel I	8.73%						
Net Income / Average RWA - Basel I	2.17%						
Factor: Liquidity						**C+**	**Weakening**
(Market funds - Liquid Assets) / Total Assets		-3.78%					
Liquidity Management			x				

Factor: Capital Adequacy						**B**	**Weakening**
Tier 1 Ratio - Basel I		9.81%					
Tangible Common Equity / RWA - Basel I		6.64%					
Factor: Efficiency						**A**	**Neutral**
Cost Income ratio	39.60%						
Factor: Asset Quality						**C+**	**Improving**
Problem Loans / Gross Loans			3.71%				
Problem Loans / (Shareholders' Equity + Loan Loss Reserves)		17.11%					
Lowest Combined Financial Factor Score (9%)						**C+**	
Economic Insolvency Override						**Neutral**	
Aggregate Score						**C**	
Assigned BFSR						**D+**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.