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Banco Davivienda S.A.

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Banco Davivienda S.A.

SACP	bbb-		+	Support	0	+	Additional Factors	0

Anchor	bb+	
Business Position	Strong	+1
Capital and Earnings	Moderate	0
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Adequate	

ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

Issuer Credit Rating
BBB-/Negative/A-3

Major Rating Factors

Strengths:	Weaknesses:
• Solid market position in the Colombian banking system and well-diversified business operations across Central America with a solid digital strategy • A systemically important bank in Colombia • Well-diversified funding structure mainly consisting of a large and stable deposit base	• Moderate risk-adjusted capitalization (RAC), reflecting a relevant amount of goodwill generated by past acquisitions • Strong competition in the Colombian and Central American financial systems pressures margins and profitability

Outlook: Negative

The negative outlook on Banco Davivienda S.A. reflects our view that if we downgrade the sovereign in the next 18 months, we could take the same rating action on the bank. This is because we rarely rate financial institutions above the long-term sovereign rating given that we believe that regulatory and supervisory powers may restrict the banks' financial flexibility during sovereign stress.

Additionally, we could lower the stand-alone credit profile (SACP) and ratings on Banco Davivienda if our projected RAC ratio falls consistently below 5%. This could happen if internal capital generation is lower than expected due to higher credit losses and loan-loss reserves, and/or greater dividend payouts coupled with higher risk charges in our model in case of a sovereign downgrade.

Upside scenario

We believe there's a low likelihood of an upgrade. The sovereign ratings on Colombia (foreign currency: BBB-/Negative/A-3) limit those on Banco Davivienda, because given its large exposure to the country (about 75%), we don't think that the bank would pass our sovereign stress test in the event of sovereign distress.

However, we could change the outlook to stable if there's a similar rating action on the sovereign, while Banco Davivienda maintains a RAC ratio above 5% and its other credit fundamentals remain unchanged.

Rationale

Banco Davivienda's business position continues to reflect the large market share in Colombia and diversified business operations in terms of geography, economic sector, and business line, which will help the bank cope with the current economic downturn. However, we expect a decrease in the bank's profitability in 2020 and 2021 due to the deteriorating loan quality and lower interest rate income, which will pressure the bank's capitalization, reflected in a forecast RAC ratio of 5.0% on average for the next 24 months. The pandemic will cause the bank's asset quality to weaken, but we expect them to remain roughly in line with the industry and regional peer averages. Finally, the bank's funding continues to benefit from a large and stable deposit base, with sufficient liquidity sources to meet short- and mid-term financial obligations. Banco Davivienda's SACP is 'bbb-'.

Anchor: 'bb+' based on the industry and average economic risk scores

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. The anchor for banks operating only in Colombia is 'bb+'.

In 2019, Colombia's GDP expanded 3.3%, one of the highest rates in the region, and lending picked up in the second half of that year, after three years of moderate expansion. However, as COVID-19 spreads to more countries, the global economy is moving toward a recession, in our view. We estimate Colombia's GDP to contract 5% this year due to the coronavirus and the collapse in oil prices. Therefore, the credit rebound will remain on hold until 2021, when we expect the economy to grow 4.5%.

In our opinion, Colombia's weakening external profile--due to the slump in oil prices and the pandemic--will pressure export revenues and widen the current account deficit. In our view, because the country has lesser capacity to absorb additional external shocks--if a global economic slowdown is prolonged or access to external funding worsens--the Colombian banking system would be more vulnerable. We believe that the increasing deficit in Colombia's current account will be transmitted to the banking system in the form of higher external funding costs and borrowing costs for sectors sensitive to currency fluctuations. However, the prolonged period of moderate credit expansion--with conservative lending practices--and limited housing price growth would mitigate a potential increase in economic imbalances in Colombia.

Table 1

Banco Davivienda S.A.--Key Figures

	--Year ended Dec. 31--				
(Mil. COP)	**2020***	**2019**	**2018**	**2017**	**2016**
Adjusted assets	140,299,790.0	120,396,422.0	108,916,852.0	98,966,954.0	91,777,227.0
Customer loans (gross)	109,543,356.0	97,399,570.0	87,821,593.0	78,219,574.0	72,929,640.0
Adjusted common equity	9,450,545.8	9,157,619.8	7,993,629.8	7,564,697.8	6,780,573.8
Operating revenues	4,323,970.0	8,091,477.0	7,364,904.0	6,853,688.0	6,513,765.0
Noninterest expenses	2,019,798.0	3,729,883.0	3,413,889.0	3,190,350.0	2,935,000.0
Core earnings	346,170.0	1,483,855.0	1,398,501.0	1,282,981.0	1,724,730.0

*Data as of June 30. COP--Colombian peso.

Business position: Large market share in the Colombian banking system and business line and geographic diversification mitigate risks amid the economic fallout.

We consider Banco Davivienda's business profile to be in a better position to face the crisis than other banks' in the region. This is because Banco Davivienda has a solid presence in in almost all of the banking product categories in Colombia, a wide geographic diversification in Central America, and well-developed digital banking platforms and technologies.

Banco Davivienda has maintained a strong market position and brand recognition in the Colombian banking system, underpinned by the loan portfolio's five-year compound annual growth of 14% as of December 2019. As of June 2020, the bank ranks second in the country in terms of total loans and first in mortgages, with market shares of about 15% and 25%, respectively. Additionally, Banco Davivienda's Central American subsidiaries, which represent about 20% of the bank's total loans, will continue to diversify the revenue base. In this sense, we expect that its operations in a wide variety of business lines, along with a solid digital strategy, will help lessen the impact of sluggish lending growth in the consumer segment. The bank aims to gradually migrate most of its operations to digital channels and improve efficiency. Accelerated by the pandemic, the number of digital customers increased to 81% in 2020 from 70% a year ago, and digital sales accounted for 43% of total product sales.

Banco Davivienda has also been an active participant in disbursements of loans to support SMEs and individual borrowers in coordination with the National Guarantee Fund and development banks, which widens the client base. Nevertheless, Banco Davivienda's portfolio growth and operating revenue will slump given stricter loan origination policies. We expect 6% lending growth in 2020, which incorporates our expectation of the exchange rates by the end of the year, and flat operating revenue growth mainly due to lower net interest margins and fees.

Finally, the bank's well-experienced and prudent management team continues to bolster Banco Davivienda's business position. We expect that it will be able to manage risk accordingly to the current conditions while it provides support to its clients.

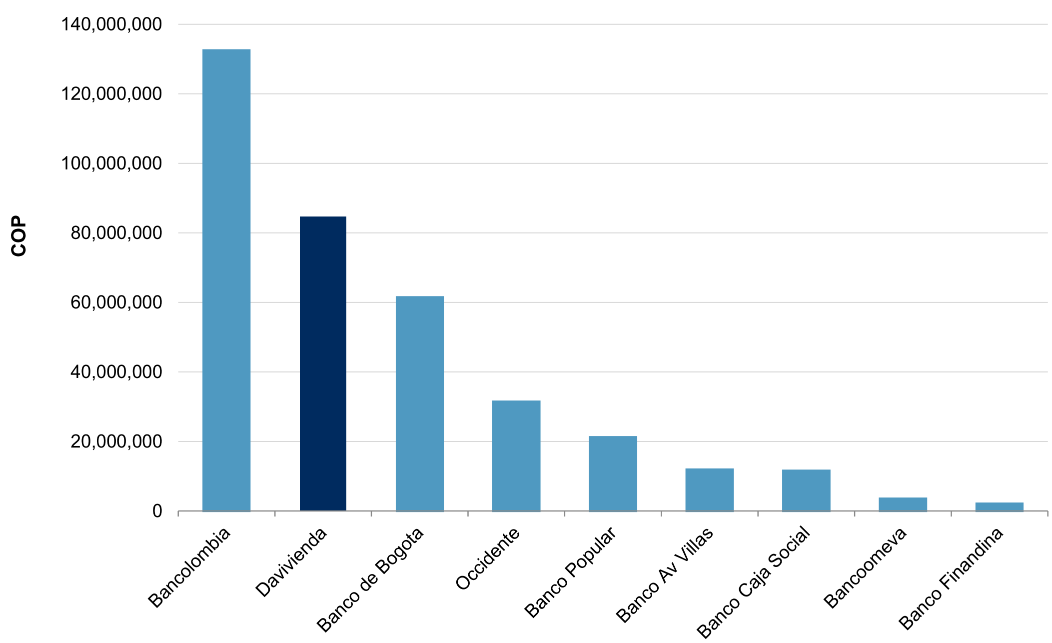
Table 2

Banco Davivienda S.A.--Business Position					
	--Year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Total revenues from business line (currency in millions)	4,323,970.0	8,091,477.0	7,364,904.0	6,853,688.0	6,513,765.0
Commercial & retail banking/total revenues from business line	97.8	97.4	96.7	96.4	92.3
Trading and sales income/total revenues from business line	1.0	0.8	2.0	1.5	2.7
Insurance activities/total revenues from business line	1.6	N/A	N/A	N/A	N/A
Other revenues/total revenues from business line	(0.4)	1.7	1.3	2.0	5.0
Investment banking/total revenues from business line	1.0	0.8	2.0	1.5	2.7
Return on average common equity	5.9	13.6	14.0	13.8	21.1

*Data as of June 30.

Chart 1

Davivienda's Share Of Total Loans In Colombia
Data as of May 2020



Source: Superintendencia Financiera de Colombia
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Capital and earnings: Forecast RAC ratio close to 5% for the next two years

We expect the bank's profitability to take a significant hit in 2020. In this sense, we foresee downward pressure on its RAC ratio mainly due to higher loan-loss provisions and, consequently, lower internal capital generation. Net income plummeted 54.2% for the 12 months ended June 2020, and we expect it to continue contracting for the rest of the year. However, limited growth in risk-weighted assets and noncash dividend payout expected for 2021 should allow the bank to mitigate these pressures and keep our capital and earnings assessment at the moderate category, with a forecast RAC ratio of 5% on average for the next two years.

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

- Colombia's GDP contraction of 5% in 2020 and growth of 4.5% in 2021;
- Loan portfolio growth of 6% for 2020;
- Net interest income to average earning assets (NIM) decreasing to about 6.1% in 2020 from 6.4% as of December 2019;
- Core earnings to adjusted assets of 0.2%;
- Efficiency levels of about 50% due to expenses related to the development of the digital platform;
- Nonperforming assets (NPAs) of about 5.3%, with reserve coverage of more than 100%, and charge-offs near 3%;
- A 28% dividend payout ratio for 2020 and noncash dividends in 2021; and
- No acquisitions in 2020 and 2021.

Banco Davivienda's quality of earnings remains adequate. As of June 2020, net interest income represented 86% of the bank's total operating revenue, while trading gains have represented less than 2% for the past three years. Nevertheless, we expect ROAA to fall to 0.2% in 2020 from 1.3% at the end of 2019. This will be due to the significant increase in credit loss provisions stemming from the eroding asset quality in 2020 and 2021 across the bank's Colombian and Central American operations. Additionally, fees and commissions revenue will fall, along with pressures in net interest margins due to lower reference rates, a change in the portfolio mix, and excess liquidity.

Table 3

Banco Davivienda S.A.--Capital And Earnings

	--Year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	7.8	8.0	8.0	7.5	6.5
S&P Global Ratings' RAC ratio before diversification	N/A	5.5	5.2	5.5	5.8
S&P Global Ratings' RAC ratio after diversification	N/A	5.1	4.8	5.1	5.5
Adjusted common equity/total adjusted capital	89.3	89.0	87.6	86.9	85.7
Net interest income/operating revenues	86.2	82.7	80.8	80.2	76.3
Fee income/operating revenues	11.6	14.7	15.9	16.3	15.9
Market-sensitive income/operating revenues	1.0	0.8	2.0	1.5	2.7
Noninterest expenses/operating revenues	46.7	46.1	46.4	46.5	45.1
Preprovision operating income/average assets	3.5	3.7	3.7	3.8	4.0

Table 3

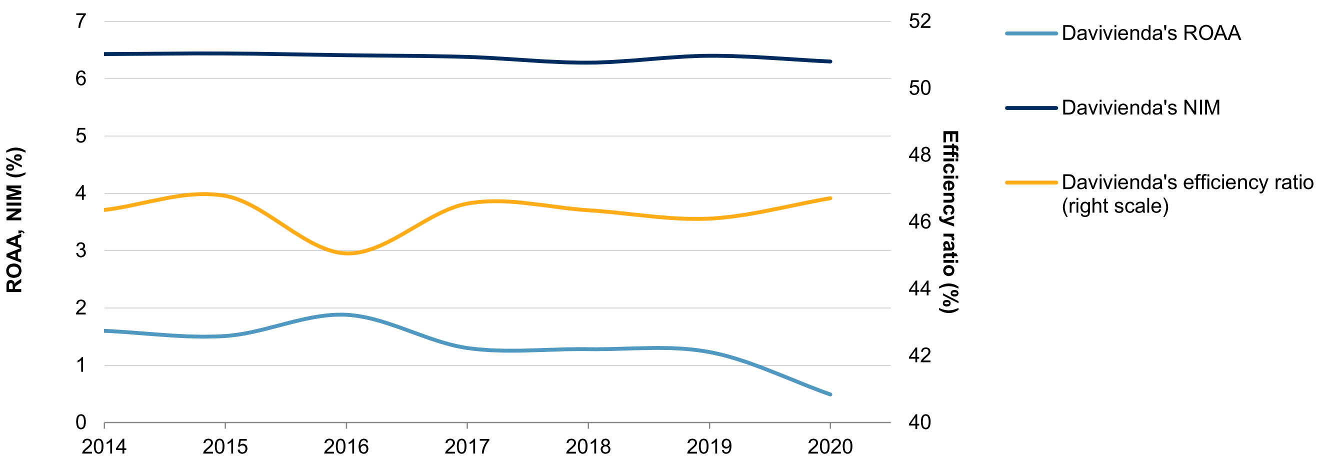
Banco Davivienda S.A.--Capital And Earnings (cont.)

	--Year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Core earnings/average managed assets	0.5	1.3	1.3	1.3	1.9

*Data as of June 30.

Chart 2

Profitability Comparison



Source: S&P Global Ratings. 2020 data as of June for Davivienda and as of May for the Colombian Banking System

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Risk position: We expect asset quality to slip at the same pace as that of its main peers.

Banco Davivienda's loan portfolio diversification in terms of economic sector and creditors, asset quality performance in line with the industry average, and historically adequate origination standards--despite above-average lending growth--supports our risk position assessment. The NPA ratio had been decreasing in the past few quarters since it peaked in December 2018 at 4.08%. However, and regardless of the client relief measures and the bank's cautious approach toward portfolio management amid the pandemic, we expect this ratio to average 5.3% in the next two years, up from 3.6% as of June 2020. The debt capacity of individual borrowers could also be severely affected, harming the credit quality of the bank's consumer loan portfolio, which expanded in recent years as well.

As of the end of July, 29% of the bank's Colombian loans and 44% of Central American loans were under the borrower relief program, totaling about 32% of total loans. This is down from the peak of 49% as of April, as clients started to service their loans again. Once this relief program ended on July 31, Banco Davivienda launched a second wave of support programs from August 1 until the end of the year targeting troubled clients in Colombia. The bank has been provisioning according to client risk profiles (no more than 10% is high risk); therefore, we expect NPAs to remain fully covered by reserves.

We expect the erosion of Banco Davivienda's asset quality to be at a similar rate as that of the banking system and closest peers. In this sense, we expect loan portfolio restructures and collection efforts over the coming months will enable asset quality metrics to recover to historical levels by the end of 2022. However, if Banco Davivienda's asset quality metrics weaken more than expected, we could reassess our risk position assessment. The bank's top 20 exposures only represent about 11% of consolidated total loans and 1.15x its total adjusted capital (TAC). These metrics are in line with previous year's levels, and we expect this to remain the case in the next 12-24 months.

Table 4

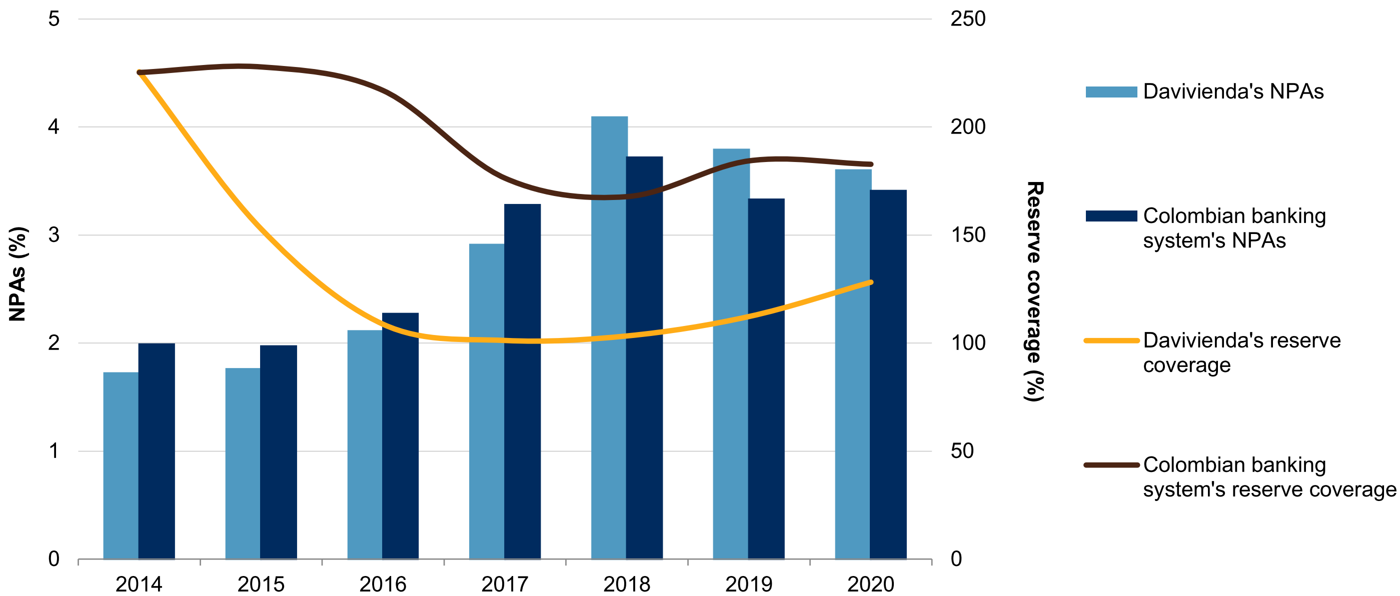
Banco Davivienda S.A.--Risk Position

	--Year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Growth in customer loans	24.9	10.9	12.3	7.3	13.8
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	8.4	9.4	7.3	6.6
Total managed assets/adjusted common equity (x)	15.0	13.3	13.9	13.3	13.8
New loan loss provisions/average customer loans	3.6	2.6	2.5	2.6	1.8
Net charge-offs/average customer loans	1.7	2.8	2.3	2.0	2.2
Gross nonperforming assets/customer loans + other real estate owned	3.6	3.8	4.1	2.9	2.1
Loan loss reserves/gross nonperforming assets	128.2	112.3	103.3	101.2	108.7

*Data as of June 30.

Chart 3

Asset Quality Comparison



Source: S&P Global Ratings. 2020 data as of June for Davivienda and as of May for the Colombian Banking System

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Funding and liquidity: Structure mostly consists of deposits, while short-term obligations are manageable.

Our funding assessment of Banco Davivienda reflects that its funding structure mainly consists of stable deposits, while the bank is able to tap wholesale and market funding. The bank maintains a very stable funding structure mainly consisting of deposits, representing 72% of the total funding sources as of June 2020. The remaining 28% consists of wholesale sources including market debt, credit lines, and repurchase agreements. Deposits rose as corporations increased liquidity mainly during the first quarter, but have remained stable even after the normalization of the mutual funds market. Therefore, we expect this funding mix to remain relatively unchanged in the coming years based on the bank's profile and strategy. Banco Davivienda's funding assessment is also supported by its long-term funding sources, resulting in a stable funding ratio (SFR) of 103.9% as of June 2020, with a three-year average of 101.8%, 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 the SFR to remain above 100%.

The bank's broad liquid assets to short-term wholesale funding ratio was 1.71x as of June 2020, compared with the 1.6x three-year average, reflecting the rise in liquidity supported by the central bank's measures to face the pandemic-induced crisis. In addition, the maturity profile of its market debt is not a concern in our opinion, and the refinancing risk has remained limited. We expect the broad liquid assets to short-term wholesale funding to be above

1.5x for the next two years, based on our expectation that the bank won't rely significantly on short-term market debt. In addition, the bank isn't exposed to significant refinancing risks in the short term, and more than 30% of its bond issuances are due in more than five years. We don't expect any change in Banco Davivienda's liquidity structure in the next 18-24 months.

Table 5

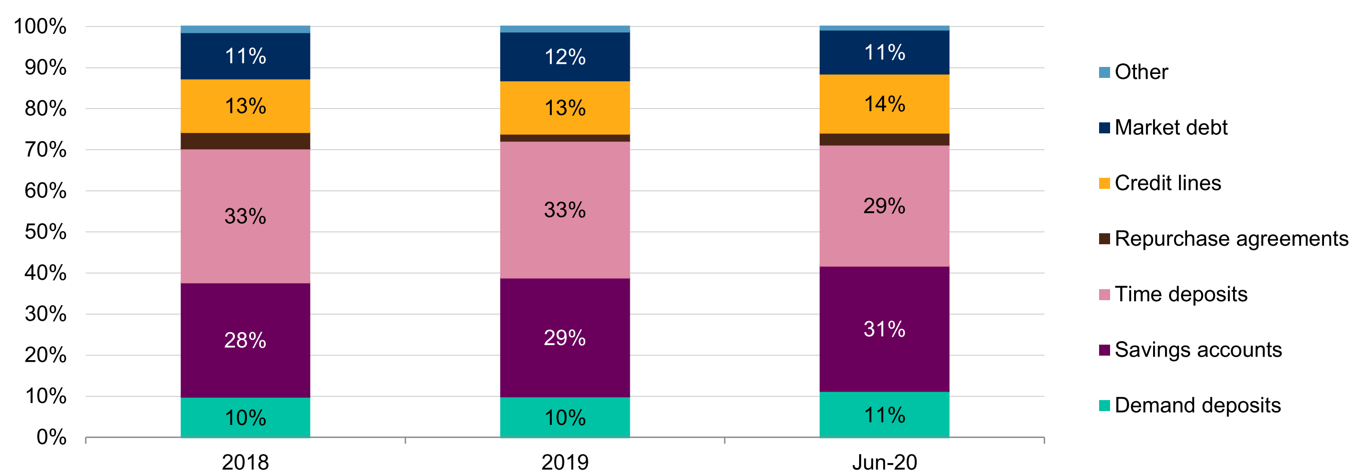
Banco Davivienda S.A.--Funding And Liquidity

	--Year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Core deposits/funding base	72.0	73.5	71.7	73.3	74.3
Customer loans (net)/customer deposits	117.5	121.5	123.0	119.9	119.5
Long-term funding ratio	90.4	91.7	89.4	91.6	92.3
Stable funding ratio	103.9	101.8	100.5	103.3	102.5
Short-term wholesale funding/funding base	10.5	9.2	11.7	9.3	8.5
Broad liquid assets/short-term wholesale funding (x)	1.7	1.7	1.4	1.8	1.7
Net broad liquid assets/short-term customer deposits	12.9	10.5	7.3	11.9	10.4
Short-term wholesale funding/total wholesale funding	36.1	33.2	39.7	33.1	31.2

*Data as of June 30.

Chart 4

Davivienda's Funding Mix



Source: S&P Global Ratings.

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Support: High systemic importance

We consider that Banco Davivienda has high systemic importance, given that it's the second-largest bank in terms of deposits and loans, along with its brand recognition. This results in a moderately high likelihood of extraordinary government support. We also consider that the Colombian government is supportive of its financial system. However, the combination of the bank's 'bbb-' SACP and the 'BBB' local currency rating on Colombia doesn't result in any uplift for the issuer credit rating on Banco Davivienda.

The bank's ultimate parent is Grupo Bolivar (not rated), a family-owned firm. Therefore, the group credit profile is equal to the 'BBB-' issuer credit rating on the bank.

Environmental, social, and governance: ESG factors have a similar influence on the Davivienda ratings as on those on its peers

We believe ESG credit factors are influencing Banco Davivienda's credit quality similarly to industry and domestic peers. Historical risk and control management have maintained the bank's reputation in Colombian and Central American banking systems. Banco Davivienda addressed and identified potential governance risk factors in order to avoid a potential hit to its reputation and, consequently, volatile bottom-line financial results. Social factors have a neutral effect on Banco Davivienda's credit quality. Adapting to changes in customer preferences is part of the bank's strategic priorities, given its large retail customer base. In our opinion, this strategy should lead to stronger bottom-line results, with improving efficiency levels in the long term, while Banco Davivienda continues expanding its client base through better services and banking experiences. Finally, although the bank has been proactive on green and social financing and market debt transactions (such as the recent COP362.5 billion social bond) and their relevance for the long-term strategy, environmental factors don't influence its credit quality above that of its peers.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- 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
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	5	6	**7**	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	**bb+**	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of August 31, 2020)*

Banco Davivienda S.A.	
Issuer Credit Rating	BBB-/Negative/A-3
Issuer Credit Ratings History	
30-Mar-2020	BBB-/Negative/A-3
02-Aug-2016	BBB-/Stable/A-3
17-Feb-2016	BBB-/Negative/A-3
Sovereign Rating	
Colombia	
Foreign Currency	BBB-/Negative/A-3
Local Currency	BBB/Negative/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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