



RATING ACTION COMMENTARY

Fitch Revises Davivienda's Outlook to Negative; Affirms IDR at 'BB+'

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Fitch Ratings - Monterrey/Bogota - 29 Nov 2023: Fitch Ratings has revised the Rating Outlook on Banco Davivienda S.A.'s (Davivienda) Long-Term Local and Foreign Currency Issuer Default Ratings (IDRs) to Negative from Stable and affirmed the IDRs at 'BB+'. Fitch has also affirmed the Viability Rating (VR) at 'bb+' and the National Long-Term rating at 'AAA(col)' Outlook revised to Negative from Stable. Fitch has additionally affirmed Grupo Bolivar S.A.'s (GB) National Long-Term Ratings at 'AAA(col)' Outlook revised to Negative from Stable.

The Negative Outlook reflects downside risk as significant assets and earnings deterioration were above Fitch expectation due greater materialization of credit risk, especially within the consumer segment, resulting in important increase of loan loss provisions. Also, Davivienda's earnings have been under pressure as funding costs were driven by the current high interest environment due to the restrictive monetary policy and the shift from demand deposits to term deposits as part of the NSFR adoption in Colombia. The Negative Outlook on Davivienda and GB National Long-Term ratings mirrors the Outlook on Davivienda's IDRs.

KEY RATING DRIVERS

VR Drives IDRs: Davivienda IDRs are driven by its VR. The VR is one notch above the 'bb' implied VR and reflects the bank's strong business profile. This factor has a positive impact on the bank's credit profile given the leading market position in Colombia as the second largest bank and adequate franchise in Central America. The assessment also considers its sound risk

management and resilient financial performance amid the recent challenging operating environment (OE), as well as its good capital position and its large and stable deposit base.

Challenging Operating Environment: Fitch expects the OE for Colombian banks to remain stable during 2024 due to lower GDP growth, inflation declining but still above the central bank's 3+/-1% target, slow decrease in funding cost and gradual improvement on asset quality after a peak reached during 2H23. Furthermore, exposure to global markets and political uncertainty will likely continue to pose challenges and headwinds to economic growth. Fitch believes sustained capitalization, resilient profitability and adequate reserves provide sufficient resilience to face stress for the banks.

Strong Business Profile: Davivienda's business profile is underpinned by its stable total operating income (TOI), strong market position in Colombia and a leading franchise in Central America. Davivienda has a diversified business model serving more than 23 million customers, offering a full suite of retail and commercial banking as well as wealth management and capital market services. The four-year average TOI is USD2,451 million is supported on business and geographic diversification and has proved resilience to its overall financial performance while control risk. Continuous efforts to develop cutting-edge digital technologies also strengthen its business model.

Risk Profile Impacted by Economic Cycle: Fitch considers the bank's risk profile as sound, supported by its well-developed credit risk standards and risk control framework. Collateral requirements (53% loan portfolio: September 2023) and risk management with well-defined systems and procedures have proven effective during periods of market turmoil. Nevertheless, the bank has not been immune to crises and economic downturns, and, since last part of 2022 and 2023, credit growth has decelerated in line with a scenario of higher interest rates and a slowdown in local economic activity. This has been accompanied by greater materialization of credit risk, especially within the unsecured consumer segment, resulting in important loan loss provisions that negatively impacted profitability.

Asset Quality Deteriorated: Davivienda asset quality deteriorated to 4.7% at September 2023 above Fitch expectations about 4% driven by greater consumer loan deterioration after a historical growth seen after the pandemic. Fitch expects that the pace of credit normalization begins on 4Q23, which is expected to be manageable thanks to the risk measures taken by the bank and the deceleration of the total portfolio. However, credit cost should remain above 3% for the next 12 months as additional provision expenses should be needed and non-performing loan ratio could remain above 4.0% as economic recovery

is expected to continue facing challenges. Moderate risk concentrations by debtor and economic sector and real guarantees partially mitigate risks, even though is not expected to see excess of loan loss reserves. The asset quality performance for its Central America operation is expected to remain stable.

Continued Provisioning and Pressured NIM Dampen Earnings: Davivienda's earnings have been under pressure as funding cost were driven by the current high interest environment and the negative impact of credit cost on profitability. Higher provisions driven by asset quality deterioration brought net income down to its lowest levels, while Net Interest Margin (NIM) was impacted by lower loan growth, especially in higher margin credits and the shift from demand deposits to term deposits as part of the NSFR adoption in Colombia. Fitch expects the profitability core metric ratio of operating profit to risk weighted assets (RWA) to contract to -0.4% at YE 2023 below the bb range and then to resume its performance in the next 12 months above 1.25%, once provisions show signs of stabilization and pressures on NIM decrease as part of the end of monetary rate-hiking cycle. Market volatility, political uncertainty and high unemployment could affect the earnings expected evolution.

Adequate Capital Metrics: Davivienda's capitalization remains adequate amid assets contraction and limited earning generation during 2023, with a common equity Tier 1 (CET1)-to-RWA ratio of 10.2% as of 3Q23 and a total regulatory capital ratio at 14.6% due to additional loss absorption provided by hybrid capital securities. Fitch expects capitalization to remain at about 11% over the next two years with a capital score of 'bb-', commensurate with the bank's planned growth and earnings recovery. Sound risk management, high collateral requirements and resilient asset quality also underpinned the bank's capitalization.

Diversified and Stable Funding: Davivienda's funding and liquidity assessment is enhanced by its good market position in deposits, supported by ample banking infrastructure and digital transformation. Loans to deposits ratio of about 114% at September 2023 was below its historical average of 121% but still above the peer average, as the bank utilizes longer-tenor funding that helps to better match its assets and liabilities.

Customer deposits show a shift from demand deposits to term deposits as part of the NSFR adoption in Colombia. Fitch expects the deposit base and regular access to capital markets to continue to boost loan growth. Conservative liquidity policies and a consolidated market position will allow the bank to fulfil regulatory liquidity ratios above 100%. The factor score

remains at 'bb+'. Davivienda's subsidiaries are funded independently in their home markets and must be self-sufficient to avoid contagion effects.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

VR, IDRs and National Ratings

- Davivienda's VRs and IDRs are sensitive to a material deterioration in the local OE or a negative sovereign rating action;
- The ratings could be downgraded if asset quality deterioration is not controlled and led profitability ratio (operating profit to RWA) consistently below 1.25%, resulting in an erosion of CET1 ratio consistently below 10%;
- A weakening of Fitch's assessment on the business or risk profile could also trigger a downgrade;
- Davivienda's national scale ratings will reflect any change in local relativities.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

VR, IDRS and National Ratings

- Given the limitations of the OE, a ratings upgrade is unlikely in the medium term;
- Over the longer term, the ratings could be upgraded by the confluence of an improvement of the OE and the bank's financial profile;
- Davivienda's national ratings have no upside potential because they are at the highest level in the national rating scale.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Davivienda's AT1 notes are rated four notches below its VR. The notching reflects the notes' higher loss severity in light of their deep subordination, and additional non-performance risk relative to the VR, given the high write-down trigger of CET1 at 5.125% and full discretion to cancel coupons. The debt has thus been affirmed due to the affirmation of Davivienda's VR.

Davivienda's local subordinated debt is rated two notches below its National Long-Term rating; two notches for loss severity (-2) and zero notches for non-performance risk (0), given the terms of the issuances (plain-vanilla subordinated debt).

Davivienda's local senior unsecured bonds are rated at the same level as the bank's National Long-Term rating, considering the absence of credit enhancement or any subordination feature.

GOVERNMENT SUPPORT RATING

The bank's Government Support rating of 'bb' reflects Davivienda's size, systemic importance and the country's historical support policy. Fitch believes there is a high probability of sovereign support. Colombia's ability to provide such support is reflected in the sovereign's Long-Term IDR (BB+/Stable).

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

--Davivienda's junior subordinated debt ratings will mirror any action on the bank's VR.

--Davivienda's local senior debt ratings would move in line with its National Long-Term rating.

--Davivienda's local subordinated debt ratings would move in line with its National Long-Term rating.

--Davivienda's GS are potentially sensitive to any change in assumptions as to the propensity or ability of Colombia to provide timely support to the bank.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

Grupo Bolivar National Ratings and Senior Debt

Grupo Bolivar's (GB) National ratings reflect the creditworthiness of its main subsidiary, Banco Davivienda. GB's ratings are aligned with Davivienda's because of its low double leverage (June 2023: 107%) supported by a high level of earnings retention and strong cash flow metrics that sufficiently meet its debt service requirements. Fitch expects a prudent dividend flow from the companies to the holding company due to the effects of the economic slowdown expected for 2024.

However, it considers that GB's prudent liquidity management, as well as the flexibility of the investment plans and contingency plans, sustains a projected cash flow that sufficiently covers the debt service for the next several years.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

--GB's National ratings will mirror any action taken on Davivienda's National ratings;

--Additionally, a substantial increase of GB's leverage (double leverage above 120%) or a sustained decline in the dividend flows from the operating companies that result in a deterioration of its debt coverage ratios could pressure GB's ratings;

--GB's national scale ratings are at the highest level on the national scale; therefore, they cannot be upgraded.

VR ADJUSTMENTS

The VR is one notch above the 'bb' implied rating due to the following adjustment reason: business profile (positive).

The Business Profile score has been assigned above the implied score due to the following adjustment reason(s): Business Model (positive).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Grupo Bolivar's ratings are driven by the rating of its main subsidiary, Banco Davivienda.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Grupo Bolivar S.A.	Natl LT	AAA(col) Rating Outlook Negative	Affirmed	AAA(col) Rating Outlook Stable
	Natl ST	F1+(col)	Affirmed	F1+(col)
senior unsecured	Natl LT	AAA(col)	Affirmed	AAA(col)
Banco Davivienda S.A.	LT IDR	BB+ Rating Outlook Negative	Affirmed	BB+ Rating Outlook Stable
	ST IDR	B	Affirmed	B
	LC LT IDR	BB+ Rating Outlook Negative	Affirmed	BB+ Rating Outlook Stable

LC ST IDR	B	Affirmed		B
Natl LT	AAA(col)	Rating Outlook Negative	Affirmed	AAA(col) Rating Outlook Stable
Natl ST	F1+(col)	Affirmed		F1+(col)
Viability	bb+	Affirmed		bb+

[VIEW ADDITIONAL RATING DETAILS](#)

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APPLICABLE CRITERIA

[National Scale Rating Criteria \(pub. 22 Dec 2020\)](#)

[Metodología de Calificaciones en Escala Nacional \(pub. 22 Dec 2020\)](#)

[Bank Rating Criteria \(pub. 01 Sep 2023\) \(including rating assumption sensitivity\)](#)

[Metodología de Calificación de Bancos \(pub. 28 Sep 2023\)](#)

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Banco Davivienda S.A.

EU Endorsed, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at <https://www.fitchratings.com/site/re/10238496>

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