Research Update:

Davivienda's 'BB+/B' Ratings Affirmed, Outlook Still Negative; Stand-Alone Credit Profile Revised To 'bb+' From 'bbb-'

February 1, 2024

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Overview

- The credit quality of Davivienda's consumer loan portfolio has deteriorated, weakening asset quality metrics compared with those of its peers and the Colombian banking sector average. We revised the bank's risk position to moderate from adequate and, consequently, the stand-alone credit profile (SACP) to 'bb+' from 'bbb-.
- The bank's profitability will fall given higher provisioning and lower net interest margins due to high funding costs; however, the expected pause in dividend payments in 2024 and a decrease in its loan portfolio growth will maintain our risk-adjusted capital ratio (RAC) ratio above 5%, our threshold for a weaker category.
- Therefore, we affirmed our global scale 'BB+/B' issuer credit ratings, the long-term of which is now in line with the SACP.
- The negative outlook on Davivienda for the next two years mirrors that on Colombia. Additionally, it incorporates the risk that the bank's lower profitability could dent capitalization levels.

Rating Action

On Feb. 1, 2024, S&P Global Ratings affirmed its 'BB+/B' global scale issuer credit ratings on Banco Davivienda S.A. (Davivienda). The outlook remains negative. We revised downward the bank's SACP to 'bb+' from 'bbb-.

Rationale

We project Davivienda's asset quality metrics to remain weak in the next 12 months. The prolonged period of elevated inflation and high interest rates has eroded households' disposable income and resulted in a deeper-than-expected deterioration in the credit quality of Davivienda's consumer loan portfolio. Moreover, Davivienda's high share of unsecured loans in its consumer loan portfolio--about 70% through credit cards and personal loans--reflects the higher risk appetite than that of the Colombian banking sector.

Consequently, Davivienda's asset quality has eroded faster than that of peers amid low economic growth, elevated inflation, and challenging labor market conditions. This caused nonperforming assets (NPAs) to total loans to increase to 4.9% as of September 2023, well above the Colombian banking system's average of 3.4%. Additionally, the bank's higher NPAs, as well as the appropriate recognition of collateral for the commercial and mortgage loans, have reduced total coverage levels to 100% from historical levels of above 110%, lower than that of its peers. In our opinion, this poses greater risks of wider credit losses for the bank amid prolonged economic hurdles.

Nevertheless, Davivienda is taking action to reverse this deterioration by strengthening its origination practices and reducing its unsecured loan portfolio. In this sense, we expect Davivienda's asset quality will stop weakening during the next six months, as its strategy to focus on secured lending will materialize, and recover gradually by the end of 2024 and first-quarter 2025.

As a result, we forecast NPAs and net charge-offs (NCOs) of about 5.1% and 3.9%, respectively, during 2023 and 4.3% and 3.2% in 2024. However, we believe these metrics will remain weaker than those of main peers and the Colombian banking system average. Therefore, we revised our assessment of Davivienda's risk position to moderate from adequate.

We expect our RAC ratio to remain between 5.8% and 6.0% for the next 12 months, mainly given improved internal capital generation and modest loan portfolio growth. The large provisioning requirements and lower net interest income--given the expected contraction in the loan portfolio and higher funding costs amid high interest rates in Colombia and implementation of the net stable funding ratio (NSFR)--will lead to negative bottom-line results in 2023. However, we expect that the recovery in internal capital generation, modest loan portfolio growth, and the expected pause in dividend payout should keep the RAC ratio between 5.8% and 6.0% in 2024.

For 2025, we expect that improved internal capital generation, given a lower cost of risk stemming from controlling the asset quality deterioration, high-single-digit loan growth, and a dividend payout in line with the historical average of about 30% will maintain capital levels stable. However, if loan portfolio growth is higher than expected or Davivienda fails to reverse the slide in asset quality that would damage profitability, our RAC ratio could drop.

We expect the bank to maintain its solid business stability with still comfortable funding and liquidity profile for the next 12 months. Davivienda's status as Colombia's second-largest bank, diversified business lines, and enhancements of digital channels provide business stability and competitive advantages over its regional peers. Moreover, given its digital expansion strategy, Davivienda's customer deposits will continue increasing, as it maintains long-term relationships with its depositors. In addition, the bank's liquidity continues to benefit from a comfortable debt maturity profile, which along with modest short-term liquidity needs, keeps the refinancing risk low.

Outlook

The negative outlook for the next two years on Davivienda mirrors that on Colombia. This is because in a sovereign stress scenario, regulatory and supervisory powers may restrict the banks' financial flexibility. In our view, banks are affected by many of the same economic factors that cause sovereign stress. Additionally, the outlook incorporates the risk that the bank's lower profitability could dent capitalization levels.

Downside scenario

We could lower the ratings on Davivienda in the next two years if we downgrade Colombia or if the bank's RAC ratio drops below 5%. This could happen if the dividend payout ratio or loan growth rate is higher than we expect or if the recovery of the bank's profits takes longer than we anticipate, weakening capital levels.

Upside scenario

We could revise our outlook on the entity to stable if we were to take the same rating action on the sovereign, as long as Davivienda's SACP remains unchanged.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	**BB+/Negative/B**	**BB+/Negative/B**
SACP	bb+	bbb-
Anchor	bb+	bb+
Business position	Strong (+1)	Strong (+1)
Capital and earnings	Moderate (0)	Moderate (0)
Risk position	Moderate (-1)	Adequate (0)
Funding	Adequate (0)	Adequate (0)
Liquidity	Adequate (0)	Adequate (0)
Comparable ratings analysis	0	0
Support	0	0
ALAC support	0	0
GRE support	0	0
Group support	0	0
Sovereign support	0	-1
Additional factors	0	0

SACP--Stand-alone credit profile.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9,

2021

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, 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: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed	
Banco Davivienda S.A.	
Issuer Credit Rating	BB+/Negative/B