Research Update:

Banco Davivienda 'BB+/B' Ratings Affirmed On Planned Integration Of Scotiabank's Operations; Outlook Still Negative

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Overview

- On Jan. 6, 2025, Banco Davivienda S.A. announced that it entered into an agreement to incorporate Scotiabank's operations in Colombia, Costa Rica, and Panama, subject to regulatory approval.
- Davivienda's presence in Central America and Colombia could widen, enhancing its business resilience. However, the integration will pose execution risks, while the banks is still working to improve its profitability and asset quality metrics.
- We're affirming our 'BB+/B' issuer credit ratings on Davivienda.
- The outlook on our rating on Davivienda remains negative, mirroring the outlook on Colombia and the risk that the bank's lower profitability could dent its capitalization.

Rating Action

On Jan. 15, 2025, S&P Global Ratings affirmed its 'BB+/B' long- and short-term issuer credit ratings on Banco Davivienda. The outlook on the long-term rating remains negative.

Rationale

The bank announced that its board of directors approved the transfer of Bank of Nova Scotia's (BNS: A+/Stable/A-1) operations in Colombia, Costa Rica, and Panama to Davivienda. We expect the transaction to be approved by regulators in respective countries and completed in the second half of 2025. Scotiabank is transferring its operations in three Latin American countries to Davivienda in exchange for an approximate 20% ownership stake in the new combined operations and participation on the board of directors.

In our view, Davivienda could face execution risks during the integration, while continue working on improving its asset quality metrics and profitability. Positively, Davivienda could expand further its presence in Central America and Colombia, strengthening its business diversification and its resilience to withstand adverse operating conditions.

We consider Davivienda's business position could strengthen. In our view, once regulators approve the transaction and operations are fully integrated, Davivienda's market share and geographic diversification will increase, improving its business resilience. Our assessment of the bank's business position already incorporates Davivienda's ability to withstand adverse operating conditions better than its domestic and regional peers. We estimate that Davivienda--the second-largest Colombian bank--will increase its market share in the country to roughly 19% in terms of gross loans and to 17% in deposits, from 15% and 14%, respectively. The bank's market share by loans will also rise in Costa Rica and Panama to 13% and 5%, respectively, nearly doubling and tripling its presence in those countries.

We expect operating revenue to continue improving for the next 12 months. In our opinion, its business diversity and competitive advantages should enable the bank to recover its growth dynamism in the two next years.

We expect Davivienda's risk-adjusted capital (RAC) ratio to remain relatively stable at about 6% for the next 12-24 months. If the transaction is approved, we estimate that Davivienda's total assets could jump about 40%, with S&P risk-weighted assets likely increasing proportionally, as new assets are in countries with very similar economic risks to those in which Davivienda currently operates. Additionally, total adjusted capital (TAC) could rise similarly, due to the new capital coming from Scotiabank, coupled with a modest dividend payout ratio. Therefore, we estimate Davivienda's RAC ratio will be between 5.8% and 6.2% in 2025-2026. We consider this range slightly higher than those of Colombian peers but lower than those of regional banks.

Despite improved profitability during 2024, we expect it will remain below historical levels during 2025, due to still high cost of risk than historical levels. Moreover, we don't anticipate significant improvements after the integration, since Scotiabank's profitability in Colombia is subpar and its Central American operations will represent a modest proportion of Davivienda's consolidated results. However, for 2026, we expect higher operating revenue and some improved efficiencies that will raise profitability.

Davivienda's asset quality will remain weaker in the next 12 months than those of its main domestic peers. Given that Colombian operations will still account for more than 70% of the bank's total loans and that Scotiabank Colombia's asset quality metrics are similar to Davivienda's, we expect asset quality will remain pressured. In our view, Davivienda's nonperforming assets and net charge-offs will be 4.0%-4.7% and 3.7%-4.8%, respectively, during 2025. These ratios will be above our expectation for the Colombian banking system's averages of 3.4% and 2.9%, respectively. Additionally, we estimate the bank's reserves coverage will remain below 100%, which is lower than its historical level of 110% (excluding collaterals) and those of its domestic peers.

Davivienda continues working to reverse its asset quality deterioration by strengthening its origination practices and shrinking its personal loan portfolio, among other measures, which have already improved its consumer loan portfolio quality. However, we believe adverse economic conditions and the uncertainty over the government's economic policies--including the implementation of ambitious social reforms--could impair clients' payment capacity and weaken credit demand, slowing Davivienda's asset quality recovery.

Davivienda will maintain a stable wholesale deposit base with healthy liquidity. We do not anticipate a significant change in Davivienda's funding structure after the integration, as both banks primarily fund their operations through wholesale deposits. In our view, Davivienda's customer deposits will continue accounting for more than 80% of the funding base, while the rest will consist of market debt, credit lines, and repurchase agreements. In this sense, we expect the bank to maintain its stable funding ratio slightly above 100%.

Although wholesale bank deposits are less stable under stress conditions, in our view, the bank has maintained long-lasting relationships with these depositors, and their share of the deposit base is in line with the Colombian banking system average. On the other hand, we consider that liquidity will remain healthy, mainly consisting of cash and equivalents, and an investment portfolio primarily allocated in government securities. Moreover, we consider its refinancing risk manageable, given Davivienda's comfortable maturity profile coupled with very low financing needs for Scotiabank's operations. Therefore, we expect the bank's broad liquid assets to cover comfortably its short-term funding needs in the next 12 months.

Environmental, social, and governance factors have no material influence on Davivienda's credit quality. We expect the bank will maintain its long-term strategy of green and social financing. The bank aims for around 30% of its total loan portfolio to focus on ESG lending by 2030. However, both factors don't influence its credit quality more than those of peers. Finally, in our opinion, the bank has clear governance practices and standards, which comply with the regulatory frameworks of the different jurisdiction in which Davivienda operates. If the transaction is approved, we consider Scotiabank's operations will follow Davivienda's ESG plan.

Outlook

The negative outlook for the next 12 months on Davivienda mirrors that on Colombia. In a sovereign stress scenario, we believe regulatory and supervisory powers may restrict the banks' financial flexibility. In our view, banks face 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.

Downside scenario

We could lower the ratings on Davivienda 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 is higher than we expect or if the profit recovery takes longer than we anticipate, weakening capital levels. We could also lower the ratings if, following the completion of the integration, the capitalization levels or asset quality diverge significantly from our base-case scenario. This could happen if the final transaction is approved in different terms.

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 stand-alone credit profile remains unchanged.

Ratings Score Snapshot

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

SACP--Stand-alone credit profile.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- 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
- 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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.