

# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Banco de Bogota S.A.

Global Credit Research - 31 Jul 2013

Bogota, Colombia

#### Ratings

| Category  | Moody's Rating |
|---|----------------|
| Outlook   | Stable         |
| Bank Deposits -Fgn Curr                           | Baa3/P-3       |
| Bank Deposits -Dom Curr                           | Baa1/P-2       |
| Bank Financial Strength                           | C-             |
| Baseline Credit Assessment                        | (baa2)         |
| Adjusted Baseline Credit Assessment               | (baa2)         |
| Senior Unsecured                                  | Baa2           |
| Subordinate                                       | Baa3           |
| <b>Parent: Grupo Aval Acciones y Valores S.A.</b> |                |
| Outlook   | Negative       |
| Issuer Rating                                     | Baa3           |
| ST Issuer Rating                                  | P-3            |
| <b>BAC International Bank, Inc</b>                |                |
| Outlook   | Stable         |
| Bank Deposits                                     | Baa3/P-3       |
| Bank Financial Strength                           | D+             |
| Baseline Credit Assessment                        | (baa3)         |
| Adjusted Baseline Credit Assessment               | (baa3)         |

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#### Key Indicators

##### Banco de Bogota S.A. (Consolidated Financials)[1]

|   | [2]12-12 | [2]12-11 | [2]12-10 | [2]12-09 | [2]12-08 | Avg.     |
|---|----------|----------|----------|----------|----------|----------|
| Total Assets (COP billion)                        | 80,506.4 | 68,809.6 | 59,346.6 | 36,475.2 | 31,552.7 | [3]26.4  |
| Total Assets (USD million)                        | 45,561.0 | 35,496.1 | 30,909.5 | 17,853.9 | 14,032.4 | [3]34.2  |
| Tangible Common Equity (COP billion)              | 4,573.5  | 3,539.4  | 761.2    | 2,236.0  | 1,680.3  | [3]28.4  |
| Tangible Common Equity (USD million)              | 2,588.3  | 1,825.8  | 396.5    | 1,094.5  | 747.3    | [3]36.4  |
| Net Interest Margin (%)                           | 5.3      | 4.0      | 3.4      | 4.2      | 4.5      | [4]4.3   |
| PPI / Average RWA (%)                             | 4.5      | 5.4      | 7.6      | 9.9      | 7.5      | [5]7.0   |
| Net Income / Average RWA (%)                      | 2.1      | 2.1      | 2.4      | 3.4      | 2.6      | [5]2.5   |
| (Market Funds - Liquid Assets) / Total Assets (%) | -13.9    | -11.5    | -9.5     | -21.0    | -14.2    | [4]-14.0 |
| Core Deposits / Average Gross Loans (%)           | 120.5    | 119.3    | 154.0    | 124.3    | 124.2    | [4]128.4 |
| Tier 1 Ratio (%)                                  | 8.4      | 7.5      | 3.8      | 12.1     | 9.1      | [5]8.2   |
| Tangible Common Equity / RWA (%)                  | 6.6      | 5.9      | 1.5      | 7.5      | 6.3      | [5]5.6   |
| Cost / Income Ratio (%)                           | 60.2     | 55.9     | 43.4     | 41.7     | 51.2     | [4]50.5  |
| Problem Loans / Gross Loans (%)                   | 1.2      | 1.3      | 1.6      | 2.2      | 1.6      | [4]1.6   |

Problem Loans / (Equity + Loan Loss Reserves) (%)                      6.2      6.8      10.9      10.1      9.1      [4]8.6  
Source: Moody's

[1] All figures and 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

### SUMMARY RATING RATIONALE

Moody's affirmed all of Banco de Bogotá S.A.'s ratings on 26 July 2013, following the July 19th announcement that the bank would acquire 98.92% of the common equity of Banco Bilbao Vizcaya Argentaria (Panamá), S.A. (BBVA Panamá, unrated) via its Panamanian subsidiary, Leasing Bogotá S.A. Panamá (Leasing Bogotá). Pending regulatory approvals, the acquisition is expected to be completed during the fourth quarter of 2013. The bank plans to eventually merge BBVA Panamá with its 100% subsidiary BAC International Bank, Inc. (BAC, D+/baa3 stable, Baa3 stable) in mid-2014.

On July 24th, Grupo Aval Acciones y Valores S.A. (Grupo Aval, Baa3 negative), Banco de Bogotá's 66.5% parent holding, announced it intends to capitalize the bank with USD 500 million to support the purchase price of USD 490 million for the BBVA Panamá acquisition, pending approval at the bank's shareholders meeting. Moody's expects the capitalization to offset the negative pressures on tangible capital originating from the second cross-border acquisition announced in less than a month. Any delay or failure to capitalize could lead to future negative actions on the bank's ratings. Further acquisition announcements or other events that affect tangible capital ratios could also prompt negative rating actions.

Though the acquisition benefits the bank's franchise through a stronger presence in the fast growing Panamanian market, it generates additional goodwill that could weaken capital ratios absent the capitalization, in the wake of its acquisition announcement of Guatemalan Grupo Financiero Reformador (Reformador, unrated) through BAC's subsidiary Credomatic International Corporation (unrated) on June 27th.

BBVA Panamá's goodwill is in addition to that associated with the acquisition of BAC in 2010, and most recently, of Reformador, which Moody's views as weakening the quality of tangible capital, as it lowers the ability to absorb potential credit losses. Under Moody's scenario analysis and adjusting capital ratios for goodwill and government risk exposures, the bank's Tier 1 capital ratio would be reduced from an already low level without the commitment to capitalize.

Banco de Bogotá's C- standalone bank financial strength rating (BFSR), equivalent to a standalone baseline credit assessment (BCA) of baa2, reflects its resilient levels of returns underscored by ample margins and an efficient cost structure. Proactive and institutionalized risk management policies ensure low levels of problem loans and maintain a good cushion of loan loss reserves and earnings that support Banco de Bogotá's low capitalization levels.

The bank has a well-established banking franchise as the second-largest in Colombia and as part of the country's largest financial conglomerate, Grupo Aval. Banco de Bogotá is also the second-largest

financial group in Central America, through its 2010 acquisition of BAC.

The bank's baa2 standalone BCA is constrained by a high growth profile and acquisitive strategy and the bank's operating environment in Colombia and Central America. Banco de Bogotá is challenged to counter competition from locally dominant peer bank Bancolombia, and in Central America, competition from larger international banks and local powerhouses.

The Baa1 local currency deposit rating is one notch above the bank's standalone BCA, in line with Moody's assessment of high systemic support for Banco de Bogotá's deposits and senior issuances given its important market shares in terms of deposits.

### Rating Drivers

- Resilient levels of returns underscored by ample margins and an efficient cost structure
- Low problem loan levels, good cushion of loan loss reserves and earnings, support the bank's low capitalization levels
- Proactive and institutionalized risk management offset the bank's family ownership. The bank is challenged by high growth profile competition in Colombia and Central America.
- Core deposit funding and ample liquidity
- Well-established banking franchise in Colombia and Central America

### **What Could Change the Rating - Down**

Negative pressure on Banco de Bogotá's standalone financial strength rating could ultimately result from a deterioration in profitability and increases in problem loans, which would directly affect the bank's capitalization.

The announcement of another major acquisition could prompt a reassessment of the bank's standalone financial strength rating.

### **What Could Change the Rating - Up**

An improvement in ratings is less likely at this juncture given that the bank is already rated, standalone, one notch above the Colombian sovereign.

### **Rating Outlook**

All ratings have a stable outlook.

### **DETAILED RATING CONSIDERATIONS**

Detailed considerations for Banco de Bogotá's ratings are as follows:

#### **Bank Financial Strength Rating**

##### **RESILIENT LEVELS OF RETURNS UNDERSCORED BY AMPLE MARGINS AND AN EFFICIENT COST STRUCTURE**

Banco de Bogotá's stable generation of core earnings results from an ample net interest margin (3-yr avg of 4.2%) related to a low cost funding base and a growing and diversifying loan portfolio, both closely referenced to the benchmark interest rate and the 90-day CD rate (DTF).

Banco de Bogotá has also successfully integrated BAC, with further beneficial effects on core earnings and their predictability, based on the business diversification that BAC's retail business brings to the bank's portfolio. The portfolio had traditionally consisted mainly of large corporations and a small consumer portfolio. With the integration of BAC, the bank now incorporates consumer as well as residential mortgages. Banco de Bogotá's credit card lending is being enhanced by BAC know-how, whilst BAC's corporate lending benefits from Banco de Bogotá's.

The bank also runs an efficient operation, with a three year-end average cost/income ratio of 53.2%. This can be explained mainly by the bank's ability to generate stable earnings, underscored by its core funding profile and cost sharing benefits related to the Grupo Aval network. The bank's efficiency levels have nevertheless been hurt by BAC's heavier cost structure.

The bank's three year-end average preprovision, pre-tax income (PPI) as percent of average RWAs is 5.8% and net income as percent of average RWAs is 2.2%.

During 2012, Banco de Bogotá reported consolidated net income of COP 1,326 billion, up 15.7%, in line with a net loan expansion of 13.5% year-over-year. As of year-end 2012, operating costs increased to 60.2% of gross operating revenues, from 55.9% as of year-end 2011, as a result of the incorporation of BAC's more cost heavy operations.

**LOW PROBLEM LOAN LEVELS, GOOD CUSHION OF LOAN LOSS RESERVES AND EARNINGS, SUPPORT THE BANK'S LOW CAPITALIZATION LEVELS**

Banco de Bogotá's conservative management and credit policies have resulted in healthy asset quality indicators and delinquency ratios that have traditionally been among the banking system's lowest. The bank's three year-end average past due loans as percentage of gross loans were 1.4% and as a percentage of loan loss reserves plus shareholders' equity were 7.9%.

Banco de Bogotá's granularity, measured by top 20 exposures against Tier 1 capital (1.2x as of year-end 2012) and core earnings (2.5x), is low and could expose the bank to potentially rapid asset quality deterioration, but from very low levels of past due loans.

Capitalization levels that are low when compared to regional peers, exhibited by an adjusted Tier 1 ratio of 8.5% (grandfathered goodwill is deducted) as of year-end 2012. This Tier 1 capital level is nevertheless assessed as adequate, based on different scenarios of credit losses, which would include a substantial deterioration in the credit quality of loans and of investments in Colombian or Central American government securities under Moody's adverse case scenario. Different probabilities of default and loss given defaults on the loan and securities portfolios, were applied against capital and the bank's high levels of reserve coverage. For capital replenishment purposes, Moody's incorporated Banco de Bogotá's earnings capabilities and reserves. The bank's capital adequacy remains unchanged with the expected incorporation of goodwill from the announced acquisitions of Reformador and BBVA Panamá, given Grupo Aval's announced intention to capitalize the bank with USD 500 million, as mentioned in the Summary Rating Rationale.

**PROACTIVE AND INSTITUTIONALIZED RISK MANAGEMENT OFFSET THE BANK'S FAMILY OWNERSHIP. THE BANK IS CHALLENGED BY HIGH GROWTH PROFILE COMPETITION IN COLOMBIA AND CENTRAL AMERICA.**

Banco de Bogotá also has a diversified business profile. In terms of products, 69% of its loans are directed to corporate loans and leases, followed by consumer loans with 24% and residential mortgages with 7%, as of year-end 2012.

Furthermore, Banco de Bogotá's operations are based in seven different countries including Colombia (73% of gross loans), Costa Rica (9%), El Salvador (4%), Honduras (4%), Panama (4%), Guatemala (3%) and Nicaragua (3%), as well as a small credit card book in Mexico, as of year-end 2012. With the acquisitions of BBVA Panamá and Reformador, the exposure to Panama and Guatemala is expected to increase to 6% and 8%, respectively. Although the credit ratings of some of these countries are below Colombia's Baa3, there is relatively low correlation among their respective operating environments, adding to the geographic diversification that shields Banco de Bogotá from potential earnings volatility in its home market.

Banco de Bogotá is ultimately family-owned with a complex ownership structure, which increases Moody's evaluation of the bank's risk profile. However, no major issues in terms of corporate governance have been observed in the bank. The bank's related party loans represent 19.2% of Fully Adjusted Tier 1 capital (three year-end average) and eight out of ten board members are considered independent.

Yet, Banco de Bogotá has a high growth profile and acquisitive strategy in select markets in Latin America and the Caribbean. The announcement of another major acquisition could prompt a reassessment of Banco de Bogotá's ratings. Furthermore, in Colombia and Central America the bank faces tough competition.

Banco de Bogotá's risk management is proactive in controlling and monitoring risk. Banco de Bogotá's supervisory board and senior executives maintain weekly discussions on risk management, largest credits outstanding, investment portfolios, and price and liquidity risk. Internal limits and operational risk are discussed quarterly. Risk management is institutional and supported by independent risk areas and good risk information systems. The bank's credit and market chief risk officer is independent from business line management yet has no veto power.

#### **CORE DEPOSIT FUNDING AND AMPLE LIQUIDITY**

Because of its ample core deposit base in all the markets in which it operates, Banco de Bogotá does not rely on either interbank or capital markets funding. Most of the bank's funding is deposit-based and sourced domestically from customers in local currency, limiting its sensitivity to contagion risks in times of stress or to a negative shift in market sentiment in the event of a sovereign crisis.

Banco de Bogotá maintains good liquidity management practices underscored mainly by a deposit-based funding diversified between Colombia and Central America and a comfortable liquidity position. The bank benefits from a broad client base of low cost core deposits (131.2% of gross loans) and ample liquidity (31.3% of total assets), for

a liquidity ratio  $[(\text{market funds} - \text{liquid assets})/\text{total assets}]$  of -11.6% (three year-end averages).

Colombian and Central American government securities, which are rated on average Ba1 in local currency, compose the bank's liquid holdings, and equal an estimated 103% and 16% of adjusted Tier 1 capital, respectively, as of year-end 2012.

Banco de la República offers Colombian banks a Transitory Liquidity Support program for repurchasing loans and securities for up to 15% of deposits, which could aid the bank in a hypothetical liquidity stress.

#### WELL-ESTABLISHED BANKING FRANCHISE IN COLOMBIA AND CENTRAL AMERICA

Banco de Bogotá has a solid market presence evidenced by its leading lending and deposit market shares in Colombia and Central America, where it is the second largest bank. Banco de Bogotá maintains a considerable geographic diversification within a macro-region of a GDP of about USD 550 billion. Founded in 1870, Banco de Bogotá is the oldest bank in Colombia and has a large footprint of 638 branches in Colombia and 492 in Central America.

As part of Grupo Aval, Banco de Bogotá's market presence in Colombia could be bolstered if all of the group's diverse banking units in the network were to be merged. Grupo Aval, owned and controlled by Dr. Luis Carlos Sarmiento Angulo, maintains extensive and dominant holdings in the financial sector. Smaller corporations are aimed by Banco de Occidente, payroll-linked consumer loans and subsovereign financing are aimed by Banco Popular and small and medium sized entities, and consumer and mortgages aimed by Banco AV Villas. Grupo Aval banks represent about a third of the Colombian banking system and share the "A Toda Hora" (ATH) banking network, with 2,731 ATMs in Colombia, as of year-end 2012. Grupo Aval is a second line of risk management for its different banks and seeks to enhance synergies and technology use, and provides services to each bank at cost.

#### Assigned Rating vs. Scorecard Outcome

As a point of reference, Moody's assigns a C- standalone financial strength rating to Banco de Bogotá, which is one notch below the scorecard-implied rating of C (see table below). Moody's believes the one notch difference incorporates the operating and competitive dynamics in Colombia and Central America, which are not fully reflected in the BFSR scorecard tool.

#### Global Local Currency Deposit Rating (Joint Default Analysis)

Banco de Bogotá's Baa1 local currency deposit rating is one notch above the bank's standalone BCA of baa2, mapped from its standalone financial strength rating of C-. The one notch difference reflects Moody's assessment of high systemic support for Banco de Bogotá's deposits and senior issuances given its important market shares in terms of deposits.

#### Foreign Currency Deposit Rating

Banco de Bogotá's long term foreign currency deposit rating of Baa3 and short term foreign currency deposit rating of Prime-3 are constrained by Colombia's country ceiling for foreign currency deposits of Baa3.

#### Notching Considerations

As a consequence of the increased probability that losses may be imposed on junior issuances, Moody's removed systemic support from subordinated debt.

Moody's assesses that under Colombian banking law, regulators have the ability to impose losses on subordinated debt holders. The assessment is also in line with global trends towards imposing losses on junior creditors in the context of future bank resolutions, which reduces the predictability of systemic support being provided to the sub-debt holders.

#### Foreign Currency Debt Rating

Moody's assigns a Baa2 long term foreign currency debt rating to Banco de Bogotá's five-year USD 600 million senior unsecured notes due 15 January 2017 (coupon of 5%). The assigned debt rating is based on Banco de Bogotá's local currency deposit rating of Baa1, but constrained by Colombia's country ceiling for foreign currency debt of Baa2.

Moody's assigns a Baa3 long term foreign currency subordinated debt rating to Banco de Bogotá's ten-year USD 500 million subordinated debt issuance due 19 February 2023 (coupon of 5.375%). The assigned subordinated debt rating is unconstrained by Colombia's country ceiling for foreign currency debt of Baa2.

## Rating Factors

Banco de Bogota S.A.

| Rating Factors [1]                                 | A       | B      | C     | D  | E  | Total Score    | Trend            |
|--|---------|--------|-------|----|----|----------------|------------------|
| <b>Qualitative Factors (70%)</b>                   |         |        |       |    |    | <b>C-</b>      |                  |
| <b>Factor: Franchise Value</b>                     |         |        |       |    |    | <b>C+</b>      | <b>Neutral</b>   |
| Market share and sustainability                    | x       |        |       |    |    |                |                  |
| Geographical diversification                       |         |        | x     |    |    |                |                  |
| Earnings stability                                 |         |        |       | x  |    |                |                  |
| <b>Earnings Diversification [2]</b>                |         |        |       |    |    |                |                  |
| <b>Factor: Risk Positioning</b>                    |         |        |       |    |    | <b>D+</b>      | <b>Neutral</b>   |
| <b>Corporate Governance [2]</b>                    |         |        |       | x  |    |                |                  |
| - Ownership and Organizational Complexity          | --      | --     | --    | -- | -- |                |                  |
| - Key Man Risk                                     | --      | --     | --    | -- | -- |                |                  |
| - Insider and Related-Party Risks                  | --      | --     | --    | -- | -- |                |                  |
| <b>Controls and Risk Management</b>                |         | x      |       |    |    |                |                  |
| - Risk Management                                  |         |        | x     |    |    |                |                  |
| - Controls   | x       |        |       |    |    |                |                  |
| <b>Financial Reporting Transparency</b>            |         | x      |       |    |    |                |                  |
| - Global Comparability                             | x       |        |       |    |    |                |                  |
| - Frequency and Timeliness                         |         | x      |       |    |    |                |                  |
| - Quality of Financial Information                 |         |        | x     |    |    |                |                  |
| <b>Credit Risk Concentration</b>                   | --      | --     | --    | -- | -- |                |                  |
| - Borrower Concentration                           | --      | --     | --    | -- | -- |                |                  |
| - Industry Concentration                           | --      | --     | --    | -- | -- |                |                  |
| <b>Liquidity Management</b>                        |         |        | x     |    |    |                |                  |
| <b>Market Risk Appetite</b>                        |         |        | x     |    |    |                |                  |
| <b>Factor: Operating Environment</b>               |         |        |       |    |    | <b>D</b>       | <b>Neutral</b>   |
| Economic Stability                                 |         |        |       | x  |    |                |                  |
| Integrity and Corruption                           |         |        |       | x  |    |                |                  |
| Legal System                                       |         |        |       | x  |    |                |                  |
| <b>Financial Factors (30%)</b>                     |         |        |       |    |    | <b>B-</b>      |                  |
| <b>Factor: Profitability</b>                       |         |        |       |    |    | <b>A</b>       | <b>Weakening</b> |
| PPI % Average RWA (Basel I)                        | 5.85%   |        |       |    |    |                |                  |
| Net Income % Average RWA (Basel I)                 | 2.17%   |        |       |    |    |                |                  |
| <b>Factor: Liquidity</b>                           |         |        |       |    |    | <b>B</b>       | <b>Neutral</b>   |
| (Market Funds - Liquid Assets) % Total Assets      | -11.64% |        |       |    |    |                |                  |
| Liquidity Management                               |         |        | x     |    |    |                |                  |
| <b>Factor: Capital Adequacy</b>                    |         |        |       |    |    | <b>C</b>       | <b>Weakening</b> |
| Tier 1 Ratio (%) (Basel I)                         |         |        | 6.59% |    |    |                |                  |
| Tangible Common Equity % RWA (Basel I)             |         |        | 4.67% |    |    |                |                  |
| <b>Factor: Efficiency</b>                          |         |        |       |    |    | <b>B</b>       | <b>Neutral</b>   |
| Cost / Income Ratio                                |         | 53.15% |       |    |    |                |                  |
| <b>Factor: Asset Quality</b>                       |         |        |       |    |    | <b>B+</b>      | <b>Neutral</b>   |
| Problem Loans % Gross Loans                        |         | 1.39%  |       |    |    |                |                  |
| Problem Loans % (Equity + LLR)                     | 7.95%   |        |       |    |    |                |                  |
| <b>Lowest Combined Financial Factor Score (9%)</b> |         |        |       |    |    | <b>C</b>       |                  |
| <b>Economic Insolvency Override</b>                |         |        |       |    |    | <b>Neutral</b> |                  |

|                      |  |      |  |
|----------------------|--|------|--|
| Aggregate BFSR Score |  | C    |  |
| Aggregate BCA Score  |  | a3   |  |
| Assigned BFSR        |  | C-   |  |
| Assigned BCA         |  | baa1 |  |

[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.



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