

Global Credit Research - 17 Jun 2015

Bogota, Colombia

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Senior Unsecured	Baa2
Subordinate	Ba1
Parent: Grupo Aval Acciones y Valores S.A.	
Outlook	Stable
Issuer Rating	Ba1
ST Issuer Rating	NP
BAC International Bank, Inc	
Outlook	Stable
Bank Deposits	Baa3/P-3
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3

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Key Indicators

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

	[2]12-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (COP billion)	118,107.3	100,402.0	80,506.4	68,809.6	59,346.6	[3]18.8
Total Assets (USD million)	49,698.4	51,968.1	45,561.0	35,496.1	30,909.5	[3]12.6
Tangible Common Equity (COP billion)	6,748.1	5,342.2	4,573.5	3,539.4	761.2	[3]72.6
Tangible Common Equity (USD million)	2,839.6	2,765.1	2,588.3	1,825.8	396.5	[3]63.6
Problem Loans / Gross Loans (%)	1.4	1.3	1.2	1.3	1.6	[4]1.4
Tangible Common Equity / Risk Weighted Assets (%)	6.5	6.0	6.3	5.6	1.4	[5]5.2
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	11.2	11.0	9.6	11.6	30.2	[4]14.7
Net Interest Margin (%)	4.6	5.1	5.2	4.0	3.4	[4]4.5
PPI / Average RWA (%)	3.9	4.5	4.3	5.1	6.9	[5]4.9
Net Income / Tangible Assets (%)	1.7	1.4	1.7	1.7	1.6	[4]1.6
Cost / Income Ratio (%)	60.6	58.6	60.2	55.9	43.4	[4]55.7
Market Funds / Tangible Banking Assets (%)	17.2	17.1	17.8	16.9	17.1	[4]17.2
Liquid Banking Assets / Tangible Banking Assets (%)	28.2	31.6	33.5	30.7	31.7	[4]31.1
Gross Loans / Total Deposits (%)	80.7	77.1	75.7	78.3	74.3	[4]77.2

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

On 10 June 2015, Moody's downgraded Banco de Bogotá S.A.'s standalone baseline credit assessment (BCA) and adjusted BCA to baa3, from baa2; long-term global local currency (GLC) deposit rating to Baa2, from Baa1; long-term foreign currency senior unsecured debt rating to Baa2, from Baa1; and foreign currency subordinate debt rating to Ba1, from Baa3.

The downgrade of Banco de Bogotá's standalone and adjusted BCAs reflects an increased emphasis placed on capitalization under Moody's new methodology, and a renewed focus on the challenges that arise from Banco de Bogotá's operations in riskier markets outside of Colombia.

According to Moody's methodology, the bank's tangible common equity to risk weighted assets is a low 6.5% as of year-end 2014, increasing to a still low 8% when related minority interest is incorporated into tangible common equity.

The bank's capitalization compares negatively with regional and global peers, and affects its capacity to absorb losses in the event of stress. Moody's tangible common equity includes the deduction of the bank's sizable goodwill, in line with Basel guidelines.

At the same time, the bank's presence in riskier countries in Central America exposes its balance sheet to greater volatility in terms of profitability and asset quality and could test the bank's capitalization going forward, despite a proactive and institutionalized risk management that ensures low levels of problem loans. Ample financial margins and an efficient cost structure, as well as a stable funding base of core deposits support the bank's baa3 BCAs.

The Ba1 foreign currency subordinate debt rating is one notch below Banco de Bogotá's baa3 BCA, following Moody's notching practices for these types of debt instruments.

The downgrade of Banco de Bogotá's long-term GLC deposit and foreign currency senior debt ratings to Baa2, from Baa1, responds to a change in the way Moody's assesses the capacity of governments to provide support to banks under the new methodology. Moody's now uses the Colombian government's Baa2 bond rating as the anchor rating to assess the level of government support for the country's most important banks. Moody's believes that the Colombian government's own bond rating of Baa2 is the appropriate measure of its ability to support banks because it captures the government's ultimate capacity to provide support. Based on insights gained from historic experience in the global markets, Moody's considers that in the case of a prolonged crisis, forbearance and liquidity measures, which were considered in the rating agency's prior assessment of government support, would be insufficient to restore confidence in a banking system, leading to the need for an outright recapitalization of financial entities.

Also on that date, Moody's assigned long- and short-term Counterparty Risk (CR) Assessments of Baa1(cr)/Prime-2(cr) to Banco de Bogotá, and affirmed the bank's long-term foreign currency deposit rating of Baa2 and short-term global local and foreign currency deposit ratings of Prime-2.

All ratings of Banco de Bogotá have a stable outlook.

BANCO DE BOGOTÁ'S RATING IS CONSTRAINED BY A WEIGHTED MACRO PROFILE OF MODERATE

Banco de Bogotá's Macro Profile is Moderate, weighted by the group's loan exposures to Colombia and Central America.

Colombia's Macro Profile is Moderate+ and represents about 60% of the bank's loan book, while its remaining operations are focused in Central America. Central American exposures include Costa Rica (Macro Profile of Moderate-), Panama (Moderate), Guatemala (Weak) and El Salvador (Weak), as well as Honduras and Nicaragua.

Colombia has a robust growth outlook, supported by strong domestic demand, though tempered by the country's low GDP per capita and high inequality. Despite average indicators for government effectiveness, the country benefits from a favorable investment climate and policy predictability. Colombia faces event risk related to its dependence on oil exports as well as ongoing problems with armed insurgencies, which have mounted an increasing number of attacks on its oil pipelines in recent years. Peace negotiations are progressing, albeit slowly.

Rating Outlook

All ratings of Banco de Bogotá have a stable outlook.

What Could Change the Rating - Up

A higher rating for the Colombian government (Baa2 stable) would add upward ratings pressure on the bank's local and foreign currency deposit and senior debt ratings.

The bank's BCA of baa3, and its Ba1 subordinate debt rating, may come under positive pressure in the event Banco de Bogotá's capitalization ratio improves materially.

What Could Change the Rating - Down

On the other hand, its standalone BCA could come under downward pressure if the bank were to experience asset quality problems that could affect its earnings generation and capital levels. An announcement of another major acquisition would prompt further reassessments of the bank's BCA, given the bank's already high levels of goodwill, which Moody's deducts from goodwill.

At the same time, downward ratings pressure on Banco de Bogotá's local and foreign currency deposit ratings and foreign currency senior debt ratings is more limited given Moody's assumption of very high government support.

DETAILED RATING CONSIDERATIONS

LOW CAPITALIZATION

Moody's views Banco de Bogotá's capitalization as low. Capitalization is expected to decrease further during the first quarter of 2015 related to further depreciation of the peso and its effect on both USD-denominated goodwill and risk weighted assets.

Moody's uses as a measure to gauge capitalization a ratio that seeks to emulate Basel's Common Equity Tier 1 (CET1) ratio, which is tangible common equity (common stock plus retained earnings minus intangibles, which in Banco de Bogotá's case is a sizable amount of goodwill).

Banco de Bogotá's tangible common equity to risk weighted assets (RWAs) of 6.5% as of year-end 2014 is low due to high holdings of goodwill. When incorporating into Banco de Bogotá's TCE its related minority interest, the bank's capitalization increases to 8%.

While as of year-end 2014, the bank's common equity is a high COP11.2 trillion (includes the Nov14 COP1.5 trillion capitalization) versus risk weighted assets of COP104.6 trillion, attributable goodwill represents a high COP4.4 trillion, mainly related to the acquisitions of:

- 1) BAC (BAC International Bank, Inc. BAC, Baa3/- stable, baa3) from GE (COP2.3 trillion in 2014) in 2010,
- 2) Banco BAC de Panamá from BBVA (COP749 million in 2014) in 2013,
- 3) Grupo Financiero Reformador (COP637 million in 2014) in 2013,
- 4) MegaBanco from the government (COP441 million in 2014) in 2005, and
- 5) AFP Horizonte from BBVA (COP425 million in 2014) in 2013.

Grupo Aval has raised upwards of COP5 trillion in the last two years, COP2.4 trillion from its shareholders and COP2.6 trillion in the NYSE Euronext, of which 56% was down-streamed to Banco de Bogotá.

Capital Is Low Even When Including Related Minority Interest

Moody's excludes minority interest because this type of capital would not be available to absorb losses at the consolidated level. Minority interest in Banco de Bogotá's case is a substantial COP3.9 trillion (versus common equity of COP11.2 trillion), mainly because of the high capitalization levels of its subsidiaries, but also because Banco de Bogotá only holds a small minority ownership in two nonetheless consolidated subsidiaries, Corficolombiana S.A. (unrated) and AFP Porvenir S.A. (unrated).

Banco de Bogotá consolidates these two entities even though it owns less than 51% in both based on a shareholder agreement. Banco de Bogotá owns 38.2% of Corficolombiana and 46.9% of Porvenir, but adding all related ownerships, Grupo Aval's ownership of these entities adds up to 57.9% of Corficolombiana and 100% of Porvenir.

The 19.8% of Corficolombiana and the 53.1% of Porvenir that is owned by related parties, represents a substantial COP1.6 trillion. These related third parties include sister entities such as Banco de Occidente S.A. (unrated), Banco Popular S.A. (unrated), Banco AV Villas S.A. (unrated) or Porvenir itself.

CHALLENGING OPERATING ENVIRONMENT

Banco de Bogotá has market presence in Colombia and Central America, a macroregion of a GDP of USD588 billion (2014), where it is the second largest bank. The bank's operations are mainly in its home market of Colombia (62% of gross loans), but with substantial presence in Panama (10%), Costa Rica (10%), Guatemala (7%), El Salvador (4%), Honduras (4%) and Nicaragua (3%), as well as a small credit card book in Mexico, as of year-end 2014. Banco de Bogotá entered Central America in 2010 with the acquisition of BAC.

While BAC has provided Banco de Bogotá with ample geographic diversification to several countries with high GDP growth and a low correlation with Colombia, it has also exposed the bank to higher volatility in assets, profitability and capitalization. Central America has higher poverty and inequality indicators, coupled with low and more volatile economic and institutional strength.

Foreign currency exposures will continue to expose the bank's capitalization to fluctuations in the valuation of assets and goodwill.

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 (4.6% as of year-end 2014) related to a low cost funding base and a growing and diversified 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 and uncorrelated operating environments bring to the bank's portfolio.

The bank's profitability is ample and largely in line with that reported prior to acquisitions with net income to tangible banking assets of 1.7%, as of year-end 2014, versus the average 1.6% of the previous three years.

During 2014, Banco de Bogotá reported a stable net income of COP1.4 trillion, flat when compared to 2013's, supported by 12% higher net interest income to COP4.5 trillion and 15% higher fee income to COP2.6 trillion, but constrained by higher 25.7% provisions related to a 22.6% growth in the portfolio. Operating expenses expanded 14%, largely in line with core earnings, for a still high cost to income ratio of 60.6%.

PROACTIVE AND INSTITUTIONALIZED RISK MANAGEMENT

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 region's lowest. The bank's acquisitions have incorporated higher 90+ days past due loans (PDL or problem loans) but remain well below the 1.5% level.

As of year-end 2014, the bank's PDLs as percentage of gross loans of 1.4% are in line with the bank's average of 1.3% during the previous three years. While we do expect some deterioration going forward, as the economy expands at a slower pace than expected, the effect should be limited by the bank's focus on commercial lending and its geographic diversification. BAC reported an also low 1.3% PDL ratio as of year-end 2014.

Banco de Bogotá has a diversified loan book with 64% of its loans directed to corporate loans and leases, followed by personal loans with 12%, residential mortgages with 10%, credit cards with 10% and car loans with 3%, as of

year-end 2014 (excludes loans to employees).

Banco de Bogotá's portfolio nevertheless has high concentrations, measured as top 20 exposures against fully adjusted Tier 1 of 1.8x or against core earnings of 2.4x as of year-end 2014, which could expose the bank to potentially rapid asset quality deterioration, but from very low levels of PDLs. These exposures are expected to increase substantially through the end of the year, as Banco de Bogotá begins to disburse large single ticket loans to infrastructure projects in Colombia.

Banco de Bogotá is ultimately family-owned, 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 10.2% of fully adjusted Tier 1 capital, as of year-end 2014.

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 Banco de Bogotá's funding is sourced from customers with deep relations with the bank, in the form of deposits in local currencies, 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's deposit-based funding is also diversified between Colombia and Central America. Deposits represent 76.9% of total funding and 117.7% of average gross loans, as of year-end 2014.

The bank's market funds are also well diversified between short-term market funds such as interbank funding (49%) and repos (19%), and more long-term, stable sources such as foreign and local issuances (19%), credit card receivable-backed funding (10%) and development bank funding that the bank is required to on-lend (5%).

The bank also maintains ample liquid assets diversified between cash and cash equivalents, Colombian government securities which are rated Baa2 and Central American government securities, rated on average Ba1 in local currency. Liquid assets represent 28.2% of total assets as of year-end 2014.

Notching Considerations

In the absence of a bail-in resolution regime framework in Colombia, as per the "Global Banks" Methodology, under "Guidelines for Rating Junior Bank Obligations", updated in July 2014, we take into account the key features of the bank's outstanding notes. As 'plain vanilla' subordinated debts with no skip mechanisms, these instruments commonly absorb losses only in a liquidation scenario. In those cases, the notching approach for 'plain vanilla' subordinated debt is one notch of subordination risk off the bank's adjusted baseline credit assessment (BCA) of the issuer.

Government Support

We believe there is a very high likelihood of government support for Banco de Bogotá's rated wholesale deposits and senior unsecured debt. This reflects Banco de Bogotá's large market share of deposits in Colombia and hence the material systemic consequences that would result from an unsupported failure. Banco de Bogotá's deposit and senior debt ratings of Baa2 benefit from one notch uplift from government support from the bank's BCA of Baa3.

Foreign Currency Debt Rating

Moody's assigns a Baa2 long-term foreign currency debt rating to Banco de Bogotá's five-year USD600 million senior unsecured notes due 15 January 2017 (coupon of 5%). The assigned rating is based on the bank's local currency deposit rating of Baa1.

Moody's assigns a Ba1 long-term foreign currency subordinate debt rating to the bank's ten-year USD500 million subordinate debt issuance due 19 February 2023 (coupon of 5.375%).

Counterparty Risk Assessments

Banco de Bogotá's long- and short-term CR Assessments are positioned at Baa1(cr)/Prime-2(cr).

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood

of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

The CR Assessment, prior to government support, is positioned one notch above the Adjusted BCA of baa3 and therefore above senior unsecured and deposit ratings, reflecting our view that its probability of default is lower than that of senior unsecured debt and deposits. We believe senior obligations represented by the CR Assessment will be more likely preserved in order to limit contagion, minimize losses and avoid disruption of critical functions.

The CR Assessment also benefits from one notch of systemic support, in line with our support assumptions on deposits and senior unsecured debt. This reflects our view that any support provided by governmental authorities to a bank which benefits senior unsecured debt or deposits is very likely to benefit operating activities and obligations reflected by the CR Assessment as well, consistent with our belief that governments are likely to maintain such operations as a going-concern in order to reduce contagion and preserve a bank's critical functions.

About Moody's Bank Scorecard

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Rating Factors

Banco de Bogota S.A.

Macro Factors	
Weighted Macro Profile	Moderate

Financial Profile						
Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
<i>Problem Loans / Gross Loans</i>	1.4%	baa1	← →	baa1	Geographical diversification	Geographical diversification
Capital						
<i>TCE / RWA</i>	6.5%	caa1	↑	b3	Access to capital	
Profitability						
<i>Net Income / Tangible Assets</i>	1.6%	baa1	← →	a3	Earnings quality	
Combined Solvency Score		ba1		ba1		
Liquidity						
Funding Structure						
<i>Market Funds / Tangible Banking Assets</i>	17.2%	baa3	← →	baa2	Deposit quality	
Liquid Resources						
<i>Liquid Banking Assets / Tangible Banking Assets</i>	28.2%	baa3	← →	baa3	Quality of liquid assets	
Combined Liquidity Score		baa3		baa2		

Financial Profile	baa3
Qualitative Adjustments	Adjustment
Business Diversification	0
Opacity and Complexity	0
Corporate Behavior	0
Total Qualitative Adjustments	0
Sovereign or Affiliate constraint	Baa2
Scorecard Calculated BCA range	baa2 - ba1
Assigned BCA	baa3
Affiliate Support notching	0
Adjusted BCA	baa3

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	0	0	baa3	1	Baa2	Baa2
Senior unsecured bank debt	0	0	baa3	1		Baa2
Dated subordinated bank debt	-1	0	ba1	0		Ba1

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