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Credit Opinion: Banco de Bogota S.A.

Global Credit Research - 02 Jul 2014

Bogota, Colombia

Ratings

Category	Moody's Rating
Outlook	Negative(m)
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
Parent: Grupo Aval Acciones y Valores S.A.	
Outlook	Negative
Issuer Rating	Baa3
ST Issuer Rating	P-3
BAC International Bank, Inc	
Outlook	Stable
Bank Deposits	Baa3/P-3
Bank Financial Strength	D+
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3

Contacts

Analyst	Phone
Felipe Carvallo/Mexico	52.55.1253.5700
David Olivares Villagomez/Mexico	
M. Celina Vansetti/New York City	1.212.553.1653
Lauren Kleiman/Mexico	52.55.1253.5700

Key Indicators

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

	[2]3-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (COP billion)	104,805.7	100,669.0	80,506.4	68,809.6	59,346.6	[3]15.3
Total Assets (USD million)	53,244.4	52,106.3	45,561.0	35,496.1	30,909.5	[3]14.6
Tangible Common Equity (COP billion)	4,864.8	5,075.2	4,573.5	3,539.4	761.2	[3]59.0
Tangible Common Equity (USD million)	2,471.5	2,626.9	2,588.3	1,825.8	396.5	[3]58.0
Net Interest Margin (%)	4.7	5.1	5.3	4.0	3.4	[4]4.5
PPI / Average RWA (%)	3.9	4.4	4.2	5.1	6.9	[5]4.9
Net Income / Average RWA (%)	2.0	1.8	1.9	1.9	2.1	[5]1.9
(Market Funds - Liquid Assets) / Total Assets (%)	-9.4	-11.8	-13.9	-11.5	-9.5	[4]-11.2
Core Deposits / Average Gross Loans (%)	111.0	127.7	121.1	119.3	154.0	[4]126.6
Tier 1 Ratio (%)	4.2	4.4	8.0	7.2	3.5	[5]5.5
Tangible Common Equity / RWA (%)	5.1	5.7	6.3	5.6	1.4	[5]4.8
Cost / Income Ratio (%)	53.6	58.6	60.2	55.9	43.4	[4]54.3
Problem Loans / Gross Loans (%)	1.4	1.3	1.2	1.3	1.6	[4]1.4

Problem Loans / (Equity + Loan Loss Reserves) (%)	**7.5**	**6.7**	**6.2**	**6.8**	**10.9**	[4]**7.6**

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

On 27 June 2014, Moody's affirmed Banco de Bogotá S.A.'s standalone bank financial strength rating (BFSR) of C-, its global local currency deposit ratings of Baa1/Prime-2 and foreign currency subordinated debt rating of Baa3. At the same time, Moody's has changed the ratings outlook to negative, from stable. Bogotá's standalone BFSR maps to a standalone baseline credit assessment (BCA) of baa2. Banco de Bogotá's foreign currency deposit and debt ratings were affirmed with a stable outlook because they remain constrained by Colombia's foreign currency country ceilings of Baa3 for deposits and Baa2 for debt.

Banco de Bogotá's fully adjusted Tier 1 capital ratio decreased about 400 basis points in September 2013, following the introduction of more stringing deductions related to minority interest and goodwill. Between June 2013 and September 2013, the bank's fully adjusted Tier 1 ratio decreased to 4.13%, from 8.04%. Banco de Bogotá has a 38.2% ownership of Corporación Financiera Colombiana S.A. (Corficolombiana) and a 46.9% ownership of AFP Porvenir, which are nevertheless consolidated. Majority ownership of both these entities is held by related parties, namely those entities belonging to the bank's holding company, Grupo Aval. The bank must deduct the minority interest in both entities held by related parties.

During the fourth quarter, there was a positive net effect on Tier 1 ratio leading to an increase to 4.43%. The net effect was related to a COP1.3 trillion capitalization versus the COP1.1 trillion goodwill incorporated from the acquisitions of Banco BAC de Panamá, S.A. (unrated) from BBVA and Guatemala's Grupo Financiero Reformador (Reformador, unrated).

However, during the first quarter of 2014, Bogotás Tier 1 ratio decreased to 4.25%, as a result of continued organic growth. Fully adjusted risk-weighted assets increased 7% during the quarter.

Banco de Bogotá's low capitalization continues to nevertheless be supported by good asset quality, within its domestic and its Central American subsidiary BAC International Bank, Inc. (BAC Credomatic, D+/baa3 stable, Baa3 stable) portfolios, as well as in the acquired portfolios from Banco BAC de Panamá and Reformador.

During 2014, Banco de Bogotá's capitalization is expected to remain stable, in line with the bank's resilient levels of returns underscored by ample margins and an efficient cost structure, versus an expected loan growth of 15%.

The bank's shareholder has expressed commitment to funding future acquisitions with fresh new capital, which would otherwise affect capitalization further. Also further extraordinary regulatory events related to capitalization are not expected during 2014. Moody's adjustments for the bank's Tier 1 capitalization ratios are related to the deduction of grandfathered goodwill from the acquisition of BAC Credomatic in 2010, for COP2.5 trillion, and risk-weighing government securities at 50%, in line with the Colombian government's Baa3 bond rating.

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.

On 19 December 2013, Banco de Bogotá acquired Banco BAC de Panamá for USD505 million via its Panamanian subsidiary, Leasing Bogotá S.A. Panamá (Leasing Bogotá). Banco de Bogotá is now seeking to merge Banco BAC de Panamá into BAC Credomatic, to be completed by mid-2014. On 23 December 2013, Banco de Bogotá acquired for USD411 million Reformador though Credomatic International Corporation (unrated), a subsidiary of BAC Credomatic.

The acquisitions benefit the bank's franchise through an important geographic diversification, with 34.5% of operations in six different Central American countries. Banco de Bogotá is also the second-largest in Colombia and part of the country's largest financial conglomerate, Grupo Aval. Banco de Bogotá is now the largest financial group in Central America in terms of assets.

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

- LIMITED LOSS ABSORPTION CAPABILITIES UNDER STRESS SCENARIOS

- PROACTIVE AND INSTITUTIONALIZED RISK MANAGEMENT POLICIES ENSURE LOW LEVELS OF PROBLEM LOANS

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

- CORE DEPOSIT FUNDING AND AMPLE LIQUIDITY

- WELL-ESTABLISHED BANKING FRANCHISE IN COLOMBIA AND CENTRAL AMERICA

What Could Change the Rating - Down

Moody's is evaluating the evolution of the bank's capitalization and loss absorption capacity, which stands today amongst the lowest of the Colombian banking system.

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

What Could Change the Rating - Up

An improvement in ratings is less likely at this juncture.

Rating Outlook

Banco de Bogotá's standalone BFSR, local currency deposit ratings and foreign currency subordinated debt ratings have a negative outlook. At the same time, its foreign currency deposit and senior unsecured debt ratings have a stable outlook.

DETAILED RATING CONSIDERATIONS

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

Bank Financial Strength Rating

LIMITED LOSS ABSORPTION CAPABILITIES UNDER STRESS SCENARIOS

Banco de Bogotá's fully adjusted Tier 1 ratio of 4.25% as of March 2014 is the lowest amongst rated Colombian banks, which in turn compare also negatively to the Tier 1 ratios of regional peers.

Banco de Bogotá's Tier 1 ratio offers a limited loss absorption even when taking into consideration the bank's low problem loans and composition of loan portfolio, within different stress scenarios of credit losses. Moody's stress scenarios include expected losses for loans and for equity and fixed-income investments. 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 expected growth levels, Banco de Bogotá's earnings capabilities and reserves.

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 4.8% vs. 4.7% as of March 2014) 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 CDT 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's 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 58.2%. 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 three year-end average preprovision, pre-tax income (PPI) as percent of average RWAs is 4.6% and net income as percent of average RWAs is 1.9%.

During the first nine months of 2013, Banco de Bogotá reported consolidated net income of COP1,078 billion, up 17.6% from the same period a year earlier, in line with a gross loan expansion of 18.3% year-over-year. Net interest income increased 19.3%.

Through September 2013, operating costs decreased to 57.0% of gross operating revenues, after having peaked at 60.2% as of year-end 2012 in line with the incorporation of BAC's more cost heavy operations.

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 three year-end average 90+days past due loans as percentage of gross loans were 1.3% and as a percentage of loan loss reserves plus shareholders' equity were 6.5%. These levels deteriorated to 1.5% and 7.5% during the first quarter of 2014 in line with higher than expected past due loans in Reformador. Banco de Bogotá's granularity, measured by top 20 exposures against fully adjusted Tier 1 capital (1.3x as of March 2014) and core earnings (2.3x), is low and could expose the bank to potentially rapid asset quality deterioration, but from very low levels of past due loans.

Banco de Bogotá also has a diversified business profile. In terms of products, 67% of its loans are directed to corporate loans and leases, followed by residential mortgages with 9%, credit cards with 9% and car loans with 3%, as of March 2014.

Furthermore, Banco de Bogotá's operations are based in seven different countries including Colombia (66% of gross loans), Panama (9%), Costa Rica (9%), Guatemala (6%), El Salvador (4%), Honduras (4%), and Nicaragua (3%), as well as a small credit card book in Mexico, as of March 2014. 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 8.2% of Fully Adjusted Tier 1 capital and eight out of ten board members are considered independent, as of March 2014.

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 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 (111.0% of gross loans) and ample liquidity (29.0% of total assets), for a liquidity ratio [(market funds - liquid assets)/total assets] of -9.4%, as of March 2014. Colombian and Central American government securities, which are rated on average Ba1 in local currency, compose the bank's liquid holdings.

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 where it is the second largest bank, and Central America where it is the second largest bank in terms of loans and the largest bank in terms of deposits. Banco de Bogotá maintains a considerable geographic diversification within a macroregion of a GDP of USD576 billion, during 2013. Founded in 1870, Banco de Bogotá is the oldest bank in Colombia and has a large footprint of 689 branches in Colombia and 494 in Central America, as of year-end 2013.

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 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 3,675 ATMs in Colombia, as of year-end 2013. 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.

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 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 USD500 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
Qualitative Factors (70%)						C-	

Factor: Franchise Value						**C+**	**Neutral**
Market share and sustainability	**x**						
Geographical diversification			**x**				
Earnings stability				**x**			
Earnings Diversification [2]							
Factor: Risk Positioning						**C-**	**Neutral**
Corporate Governance [2]				**x**			
- Ownership and Organizational Complexity	--	--	--	--	--		
- Key Man Risk	--	--	--	--	--		
- Insider and Related-Party Risks	--	--	--	--	--		
Controls and Risk Management		**x**					
- Risk Management			x				
- Controls	x						
Financial Reporting Transparency		**x**					
- Global Comparability	x						
- Frequency and Timeliness		x					
- Quality of Financial Information			x				
Credit Risk Concentration	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management			**x**				
Market Risk Appetite			**x**				
Factor: Operating Environment						**D**	**Neutral**
Economic Stability				**x**			
Integrity and Corruption				**x**			
Legal System				**x**			
Financial Factors (30%)						**B**	
Factor: Profitability						**B+**	**Weakening**
PPI % Average RWA (Basel I)	4.58%						
Net Income % Average RWA (Basel I)		1.89%					
Factor: Liquidity						**B**	**Neutral**
(Market Funds - Liquid Assets) % Total Assets	-12.39%						
Liquidity Management			x				
Factor: Capital Adequacy						**C+**	**Weakening**
Tier 1 Ratio (%) (Basel I)			6.55%				
Tangible Common Equity % RWA (Basel I)		5.89%					
Factor: Efficiency						**C**	**Neutral**
Cost / Income Ratio			58.23%				
Factor: Asset Quality						**B+**	**Neutral**
Problem Loans % Gross Loans		1.30%					
Problem Loans % (Equity + LLR)	6.53%						
Lowest Combined Financial Factor Score (9%)						**C+**	
Economic Insolvency Override						**Neutral**	
Aggregate BFSR Score						**C**	
Aggregate BCA Score						**a3**	
Assigned BFSR						**C-**	
Assigned BCA						**baa2**	

[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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