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Research Update:

Banco de Bogota S.A. y Subsidiarias 'BBB-/A-3' Ratings Affirmed; Outlook Negative

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Overview

- BBogota continues to hold a leading position in Colombia and in Central America through its core subsidiary BAC International Bank.
- The bank's capital and earnings assessment is mainly driven by our projected risk-adjusted capital (RAC) ratio of around 4.5%-4.9% during the next 18 months.
- We are affirming our long-term 'BBB-' and 'A-3' short-term global issuer credit ratings on the bank.
- Our negative outlook on BBogota reflects that on Colombia. The ratings continue to reflect one notch of government support, given the bank's high systemic importance to the Colombian financial system.

Rating Action

On August 4, 2016, S&P Global Ratings affirmed its long-term 'BBB-' and short-term 'A-3' global scale issuer credit ratings on Banco de Bogotá S.A. y Subsidiarias (BBogota). At the same time, we are affirming the ratings on BBogota's senior unsecured debt at 'BBB-'. The outlook is negative.

Rationale

The credit ratings on BBogota continue to reflect its strong business position, with a leading position in most of the countries where it operates. They take into account its weak capital and earnings, reflecting our projected risk-adjusted capital (RAC ratio in the range of 4.5%-4.9% during the next 18 months. We also take it adequate risk position, sustained by its adequate and stable asset quality metrics, and average funding, which is underpinned by its large and stable deposit base. Its adequate liquidity is equally important in our assessment. Its stand-alone credit profile (SACP) is 'bb+'.

Our bank criteria use our banking industry country risk assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for BBogota is 'bb+', reflecting the weighted average economic risk of '7', given the countries in which the bank has its major loan portfolio exposures--Colombia (54.8%), Panama (12.5%), Costa Rica (11.9%), Guatemala(7.9%), Honduras (4.7%), and El Salvador (4.3%). The industry risk score for Colombian banks is '5', with a negative trend, reflecting our opinion of the financial system's increasing dependence on domestic wholesale funding sources that represents a vulnerability.

Colombia's economic risk assessment reflects its slowing economy and deterioration in the country's trade balance, which is mainly due to the low prices of oil and coal. We believe that Colombia's external debt and liability position will weaken further because of reliance on higher debt financing during the next two years to partly finance the widening current account deficit. As a result, higher economic imbalance risks, in our view, would pressure Colombian financial institutions. On the other hand, low-income household levels (GDP per capita is projected to remain below $6,500 during 2016 and 2017) along with modest growth in real wages could raise credit risk in the economy. Peso depreciation, high inflation, as well as the impact of low oil prices on the domestic economy and increasing lending rates, could further pressure household income capacity. Given lower global commodity prices, Colombia's GDP slowed to 3.1% in 2015 and will likely be 2.3% in 2016 and 3.0% in 2017, down from 4.5% in 2014. We believe that the slowing economy could be a drag on domestic credit expansion. Overall, we expect total loans to grow 10%-11% in 2016 and about 12%-13% by the end of 2017, compared with a compound annual growth rate of 20% for the past six years.

Colombian banks' moderate risk appetite and the absence of market distortions support our industry risk assessment. Core deposits have proven stable even during periods of market turmoil; however, credit keeps expanding at a faster pace than total deposits, and the share of retail deposits remains low (estimated below 30% of total deposits). The latter could increase risks because of greater dependence on wholesale funding, which we consider less stable during times of economic and market distress. Since 2016, the central bank is centralizing all government entities' financial surpluses, and commercial banks had to find alternative funding sources to compensate for the exit of those cheap resources. In addition, corporations related to the oil sector and entities whose primary raw materials are denominated in foreign currency have been exposed to low oil prices and to the Colombian peso's significant depreciation against the dollar. Those entities have had lower cash flows and financial resources to channel into the financial system in the form of deposits. In order to replace those funds, banks have been tapping the local debt capital market, which has proved to be moderately broad and deep, allowing investment and non-investment grade entities to access funds with medium to long-term maturities. Moreover, despite recent regulatory changes to strengthen the system's capitalization, we still believe there is room for improvement in Colombia's regulatory framework and track record. However, transparency in Colombia's financial system is, in general, greater than its regional peers.

BBogota's business position is strong and we expect it to remain so. The bank continues to reflect its leading position in Colombia and in Central America through its core subsidiary BAC International Bank. As of March 31, 2016, BBogota is the second-largest bank in Colombia, with a market share of 15% by total assets, just behind Bancolombia, S.A. y Companias Subordinadas (BBB-/Negative/A-3), which hold 23% of the market in Colombia, respectively. BBogota's size is even larger including its operations throughout Central America, which represents about 37% of BBogota's consolidated assets as of

March 2016. Furthermore, the bank's operating revenues have increased, consistently supported by the bank's leading position in most of the business segments and countries in which it participates, ultimately supporting its business stability.

The bank's business diversification by product and geography has also remained sound and continued to improve. As of March 2016, BBogota's loan portfolio is composed of commercial loans (62.1%), consumer loans (26%), microlending (0.4%), and mortgages (11.5%). In contrast to BBogota's exposure in Colombia, in Central America the bank is highly oriented toward the consumer segment, mainly mortgages and credit cards. In terms of geography, its business has the most exposure to Colombia--55% as of March 2016, compared with 61% last year. The drop in this percentage was an effect of Colombian peso depreciation of about 30% in 2015. We expect BBogota's total loans to grow around 11% on average for the next two years because we expect the bank's growth strategy will be conservative in light of economic challenges in Colombia and Central America, and given that we do not expect the Colombia peso to depreciate as much as in 2015. Our loan growth projection considers the organic growth in Colombia and in the Central American countries with no expected acquisitions. We believe its highest exposure will remain in Colombia--between 53%-58% in 2016 and 2017.

BBogota's capital and earnings assessment is weak. We expect its RAC ratio to be in the 4.5%-4.9% range during the next 18 months. The bank's adequate quality of capital and earnings and internal capital generation, compared with other banks we rate in the region, also underpin this score. Our financial forecasts reflect our base-case assumptions, which include:

- Colombia's GDP will grow about 2.3% in 2016 and 3.0% in 2017;
- Lower foreign exchange volatility in the next two years: COP3,250/$1 and COP3,200/$1 for 2016 and 2017, respectively;
- Considering expected exchange rates, the Corficolombiana deconsolidation, and no expected additional acquisitions during the next 24 months, we are projecting a -2.5% goodwill decrease for 2016 and -1.5% for 2017;
- The Corficolombia deconsolidation will directly lead to:
- A decrease of 18% and 22% in 'other earning assets' (investments) and 'all other assets' (mainly fixed assets and other intangibles), respectively. These reductions are mainly driven by the loss of Corficolombiana's securities, intangible assets, and fixed assets. The total amount will be COP20 billion;
- A minority equity decrease of 75%, coupled with around COP15 billion decrease in the bank's total liabilities;
- As a consequence, total assets will be almost flat for 2016 and will increase 9.3% for 2017, leading to credit risk-weighted assets of -0.4% and 9.7% in 2016 and 2017, respectively;
- Additionally, we are expecting a 17.1% increase in market risk, reflecting the bank's 38% participation in Corficolombiana.
- Consolidated loan portfolio growing, on average, about 12% for the next two years;
- Net interest margin (NIM) gradually increases, reflecting the growing

participation of small and mid-size enterprises (SMEs) and consumer loans within BBogota's consolidated loan portfolio, which would somewhat offset the increasing funding costs;
- Profitability levels are stable during the next 24 months, with core earnings to adjusted assets of 1.75% and an efficiency ratio (measured by non-interest expenses to operating revenues) of 53%. Additionally, we expect credit loss provisions to represent around 12%-14% of operating revenues;
- Nonperforming assets (NPAs) and net charge offs ratios standing at about 1.78% and 1.33%, respectively, with full reserve coverage;
- An average dividend payout ratio of 42.5% for the next two years; and
- No acquisitions.

The bank's quality of capital is not high due to the relatively high participation of goodwill in its capital base; this goodwill is denominated in foreign currency, so in the event of higher than expected depreciation of the Colombian peso, the RAC ratio could come under pressure. Quality of earnings remains adequate. Profitability metrics--which place the bank in a good position with respect to peers in the region and globally--are the main reasons for this assessment. As of March 2016, core earnings to average adjusted assets stood at 1.59% and have averaged 1.99% over the past three fiscal years, which is higher than similar local and regional peers. Moreover, efficiency has also remained very stable and at sound levels, with a ratio of 52.38% as of March 2016 (51.89% on average over the last three fiscal years). In our view, BBogota's profitability levels will be supported by the bank's efforts to improve efficiency during the next two years.
In our view, the bank's adequate risk position reflects BBogota's adequate risk diversification and manageable asset quality metrics compared to other banks in the country and in the region. Moreover, we believe the bank has adequate growth and exposure despite significant loan portfolio growth in the last year.

BBogota's total loans increased significantly during 2015, but we expect it to moderate during the next 12-18 months. However, for the next year, we are considering 12% growth on average, which is in line with our projection of 10%-11% growth for the Colombian banking system in 2016 and 12%-13% in 2017. In our view, the bank's moderating loan growth will allow it to keep its manageable asset quality metrics relatively stable. BBogota's nonperforming assets (NPAs) slightly increased to 1.76% as of first quarter 2016 and have averaged 1.57% in the last three fiscal years –-ratios still below the average of the Colombian banking system of 2.15% at the same date. All NPAs are fully covered by the bank's loan loss reserves and we expect them to remain so going forward. Regarding net charge offs (NCHs), BBogota's NCHs represent 1.12% as of December 2015, similar to 2014 levels of 1.18%. For the next 12 to 18 months, we are forecasting NPAs to be around 1.78% and credit losses remain low at around 1.33%.

BBogota has remained well-diversified and has no significant exposure to oil and gas (or related sectors). As of March 2016, its loan portfolio was mainly comprised by: construction (7.26%), oil and gas (6.79%), transportation

(5.99%), automotive (3.5%); the remainder is distributed among other industries. The increase in infrastructure projects due to the 4G impact has been marginal and has not weakened its loan portfolio diversification; the expected projects will reach around 1% of the bank's consolidated loan portfolio until 2017. Moreover, its top 20 largest exposures only represented 9.38% of its loan portfolio and 48.84% of its total reported equity as of March 2016. This level compares positively against its regional peers.

In our view, the bank's average funding reflects its funding structure, mainly composed of customer deposits (41.97% are time deposits), which accounted for 74.7% of total funding sources, followed by wholesale operations. These wholesale activities are divided between interbank loans, repurchase agreements, and market debt. As of March 2016, BBogota's top 20 depositors represented around 17% of BBogota's total consolidated deposit base. We expect it to remain below 20% for the next 18 months. The bank has satisfactory stable funding ratios (SFRs), with an average of 111.2% for the past three fiscal years and 109.67% during the first quarter 2016. Given its expected stable funding needs and funding structure for the next two years, we anticipate its SFR will remain above 100%.

Our liquidity assessment remains adequate, mainly supported by its coverage of short-term wholesale funding with liquid assets and by its comfortable debt maturity profile. BBogota's short-term wholesale funding is low--representing less than 15% of its funding base--and it has manageable refinancing risk over the next 12 months. As of March 2016, our broad liquid assets to short-term wholesale funding ratio stood at 2.47x with a three-year average of 2.8x. Its liquidity management is prudent, with no significant debt maturities during the next year. Moreover, all debt is issued in foreign currency and represents less than 10% of total funding sources. We anticipate adequate liquidity management with comfortable debt maturities going forward.

Our ratings on Bbogota incorporate one notch of government support, given the bank's high' systemic importance, coupled with our view of the government as supportive towards its financial system, which results in a moderately high likelihood of extraordinary government support to BBogota. The combination of its 'bb+' SACP and the sovereign 'BBB+' local currency rating on Colombia result in a 'BBB-' credit rating on the bank.

Outlook

The negative outlook on BBogota reflects that on Colombia. The ratings show one notch government support, given the bank's high systemic importance to the Colombian financial system. However, if we were to downgrade the sovereign, which already has a negative outlook, we will downgrade the bank, provided its SACP is 'bb+' at that juncture.

Moreover, if the bank's total adjusted capital (TAC) is pressured by increasing goodwill and higher-than-expected credit expansion (due to Colombian peso depreciation), and, correspondingly, its RAC ratio falls to below 3%, we will revise our SACP and downgrade the bank.

We believe the bank will remain one of the largest players in Colombia and Central America, while maintaining a conservative approach toward risk and liquidity management.

Rating Score Snapshot

Issuer Credit Rating	BBB-/Negative/A-3
SACP	bb+
Anchor	bb+
Business Position	Strong (+1)
Capital and Earnings	Weak (-1)
Risk Position	Adequate (0)
Funding and liquidity	Average and Adequate (0)
Support	0
GRE Support	0
Group Support	0
Government Support	+1
Additional Factors	0

Related Criteria And Research

Related Criteria

- Group Rating Methodology -- Nov. 19, 2013
- Banking Industry Country Risk Assessment Methodology And Assumptions -- Nov. 9, 2011
- Banks: Rating Methodology and Assumptions -- Nov. 9, 2011
- Bank Capital Methodology And Assumptions -- Dec. 6, 2010
- Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions -- July 17, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework -- June 22, 2012
- Commercial Paper I: Banks -- March 23, 2004
- Use Of CreditWatch And Outlooks -- Sept. 14, 2009
- Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions -- Jan. 29, 2015

Related Research

- Brazil's Recession Continues To Drag Down Latin America's Credit Outlook For 2016, April 15, 2016
- Will Pressure Increase On Latin American Banks In 2016?, Nov. 18, 2015
- External Factors And Weak Economies Continue To Pose Challenges For The Top 30 Latin American Banks, Sept. 29, 2015

Ratings List

Ratings Affirmed

Banco de Bogota S.A. y Subsidiarias	
Counterparty Credit Rating	BBB-/Negative/A-3
Senior Unsecured	BBB-

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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.