

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

Global Credit Research - 11 Feb 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]6-12	[2]12-11	[2]12-10	[2]12-09	[2]12-08	Avg.
Total Assets (COP billion)	73,747.1	68,809.6	59,346.6	36,475.2	31,552.7	[3]23.6
Total Assets (USD million)	41,319.7	35,496.1	30,909.5	17,853.9	14,032.4	[3]31.0
Tangible Common Equity (COP billion)	4,142.9	3,539.4	761.2	2,236.0	1,680.3	[3]25.3
Tangible Common Equity (USD million)	2,321.2	1,825.8	396.5	1,094.5	747.3	[3]32.8
Net Interest Margin (%)	5.4	4.0	3.4	4.2	4.5	[4]4.3
PPI / Average RWA (%)	4.8	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 (%)	-12.5	-11.5	-9.5	-21.0	-14.2	[4]-13.7
Core Deposits / Average Gross Loans (%)	113.9	119.3	154.0	124.3	124.2	[4]127.1
Tier 1 Ratio (%)	12.1	12.0	8.9	14.0	11.2	[5]11.6
Tangible Common Equity / RWA (%)	6.5	5.9	1.5	7.5	6.3	[5]5.5
Cost / Income Ratio (%)	57.9	55.9	43.4	41.7	51.2	[4]50.0
Problem Loans / Gross Loans (%)	2.9	2.8	3.7	4.6	3.4	[4]3.5

Problem Loans / (Equity + Loan Loss Reserves) (%)                      14.4      14.1      25.0      21.3      20.0 [4]19.0  
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

Banco de Bogotá S.A.'s C- standalone financial strength rating reflects its resilient levels of returns underscored by ample margins and an efficient cost structure. The bank's 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 more aggressive 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 Acciones y Valores S.A., Baa3 negative). Banco de Bogotá is also the second-largest financial group in Central America, through its 2010 acquisition of BAC International Bank, Inc. (BAC, D+/baa3/Baa3). Banco de Bogotá's C- standalone financial strength maps to a standalone BCA of baa2.

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 announcement of another major acquisition could prompt a reassessment of Banco de Bogotá's ratings.

Banco de Bogotá's Baa1 local currency deposit rating is one notch above the bank's standalone BCA of baa2, 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.

### Recent Events

On 7 February 2013, Moody's assigned a long term foreign currency subordinated debt rating of Baa3 to Banco de Bogotá's proposed ten-year subordinated debt issuance. The rating reflects Moody's assessment that under Colombian banking law, regulators have the ability to impose losses on subordinated debt holders. The rating action 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 such support being provided to the sub-debt holders of Banco de Bogotá.

On 22 May 2012, Moody's confirmed Banco de Bogotá's C- standalone financial strength rating, which translates to a baa2 standalone credit assessment. The bank's cross-border diversification, relatively lower exposure to Colombian government risk via holdings of government securities or loans and limited reliance on confidence-sensitive market funding, enabled the bank's baa2 standalone BCA to remain one notch above the Baa3 Colombian government bond rating.

### 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 past due 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.

### **Recent Developments**

Banco de Bogotá's BAC acquisition was concluded on 9 December 2010 and was financed with a USD1.29 billion capital injection in the form of equity-convertible debt (BOCEAs - Bonos Obligatoriamente Convertibles en Acciones, which were fully converted on November 2011) and by USD360 million in cash. A USD1 billion bridge loan from a consortium of international banks was taken on to hedge the foreign currency acquisition. On December 2011, Banco de Bogotá issued USD600 million senior debt due 2017 (which is rated at Baa2 by Moody's, with a stable outlook) and USD500 million term loan, in order to prepay that bridge loan. The bank is expected to issue a ten-year subordinated debt (which was rated Baa3 by Moody's on 7 February 2012, with a stable outlook) to repay the three-year USD500 million term loan.

### **Recent Results**

During the first half of 2012, Banco de Bogotá reported consolidated net income of COP664.8 billion, up 14.5%, in line with a net loan expansion of 17.1% year-over-year and an increase of 13.8% in net interest income.

As of June 2012, operating costs remain at a good 57.9% of gross operating revenues, nevertheless up from 55.9% as of year-end 2011, comparing substantially more negative to the three year-end average of 47.0%, as a result of the incorporation of BAC's more cost heavy operations

The bank's problem loans (C, D or E classified loans) represent 2.9% of gross loans after having decreased from 3.3% from a year ago. Reserve coverage of gross loans is also high at 2.67%, as of June 2012.

Funding is mainly composed of low cost core deposits which as of June 2012 represented 113.9% of gross loans, down slightly from 119.2% as of year-end 2011. On the other hand, the bank's liquidity ratio [(market funds - liquid assets)/total assets] improved slightly to -12.5%, from -11.5%, as market funding decreased slightly. Interbank and capital market funding represented 16% and 3% of its total funding, as of June 2012.

As of June 2012, the Tier 1 ratio was 12.1%, in line with the 12.0% as of year-end 2011. Tangible common equity as a percentage of risk weighted assets (RWAs) is low at 6.5%, and up slightly from 5.9% as of year-end 2011, reflecting the large goodwill that Banco de Bogotá incorporated with the BAC acquisition.

Banco de Bogotá is headquartered in Bogotá, Distrito Capital and is the second largest bank in Colombia in terms of loans. As of June 2012, Banco de Bogotá reported total assets of USD41.3 billion, gross loans of USD23.4 billion, deposits of USD26.1 billion, and shareholders' equity of USD4.1 billion.

### **DETAILED RATING CONSIDERATIONS**

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

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

##### **PROFITABILITY**

Banco de Bogotá's stable generation of core earnings results from an ample net interest margin based on a low cost funding base and a growing and diversifying loan portfolio, both closely referenced to Banco de la República's (the Colombian central bank) benchmark interest rate and the 90-day CD rate (DTF). The bank's net interest margin has averaged 3.9% for the last three year-ends.

Banco de Bogotá is also successfully integrating its large cross-border acquisition of BAC, with further beneficial effects on the bank's core earnings and their predictability, based on the business diversification that BAC's retail business brings to Banco de Bogotá's portfolio. The bank's 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 through the incorporation of BAC know-how, whilst BAC's corporate lending is benefitting from Banco de Bogotá's.

The bank also runs an efficient and consistently improving operation, with a three year-end average cost/income ratio of 47.0%. 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 (see Recent Results).

The bank's three year-end average preprovision, pre-tax income (PPI or core earnings) as percent of average RWAs is 7.6% and net income as percent of average RWAs is 2.6%.

#### ASSET QUALITY AND CAPITALIZATION

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 Colombian banking system's lowest. The bank's three year-end average problem loans (C, D or E classified loans) as percentage of gross loans were 3.7% and as a percentage of loan loss reserves plus shareholders' equity were 20.1%.

Banco de Bogotá's granularity, measured by top 20 loans against Tier 1 capital and PPI, is low yet in line with that of other similarly rated Latin American banks.

Banco de Bogotá reports aggressive capitalization levels and are low when compared to regional peers. The unadjusted Tier 1 ratio of 11.6% and tangible common equity to RWAs of 5.0% (three-year average), are 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, and excluded goodwill from the bank's reported Tier 1 capital.

Due to its limited exposure to government debt, Banco de Bogotá is relatively well insulated from a government debt crisis that could undermine its solvency.

#### RISK POSITIONING

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 23% and residential mortgages with 8%, as of June 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. Although the credit ratings of some of these countries where Banco de Bogotá operates 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 a mere 9.0% of 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 Banco de Bogotá faces tough competition from the largest bank, Bancolombia, and the third largest bank, Davivienda. In Central America, the bank faces competition from local powerhouses, such as Costa Rica's government owned BCR and BNCR, El Salvador's Bancolombia and Davivienda subsidiaries,

Panama's Banco General or Guatemala's Industrial. Citibank and Scotiabank, present throughout the subcontinent also present a challenge.

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.

Quarterly consolidated ("sector financiero y real") financial statements and reports began to be published in June 2012; before this date, consolidated financial statements were made available only semi-annually. The different regulators in the region publish unconsolidated financial statements on a monthly basis, on average providing adequate insight into asset quality, and profitability. Consolidated financial statements are published under Colombian Banking GAAP, BAC's financial statements are published in US GAAP, and unconsolidated statements under each country's local GAAP. Financials have traditionally been audited by internationally recognized auditing firms.

## FUNDING AND 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 (132.5% of gross loans) and ample liquidity (31.6% of total assets), for a liquidity ratio [(market funds - liquid assets)/total assets] of -14.0% (three year-end averages). Interbank and capital market funding on a three year-end average represent 14% and 4% of its total funding.

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 77.2% and 11.9% of Tier 1 capital, respectively, as of year-end 2011.

The bank's deposits from individuals nevertheless represent a low 24.8% of total deposits, as of June 2012 (consolidated figures).

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 Banco de Bogotá in a hypothetical liquidity stress.

## FRANCHISE VALUE

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 USD475 billion. Founded in 1870, Banco de Bogotá is the oldest bank in Colombia and has a large footprint of 637 branches in Colombia and 490 in Central America, as of October 2012.

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 June 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. On 7 February 2013, Moody's assigned a rating to Banco de Bogotá's proposed subordinated debt at one notch below the adjusted standalone BCA of baa2, in line with "Moody's Guidelines for Rating Bank Hybrid Securities and Subordinated Debt."

### 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 proposed ten-year subordinated debt issuance. 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			
Earnings Diversification [2]							
<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	--	--	--	--	--		
Liquidity Management			x				
Market Risk Appetite			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>Improving</b>
PPI % Average RWA (Basel I)	7.64%						
Net Income % Average RWA (Basel I)	2.61%						
<b>Factor: Liquidity</b>						<b>B</b>	<b>Weakening</b>
(Market Funds - Liquid Assets) % Total Assets	-14.01%						
Liquidity Management			x				
<b>Factor: Capital Adequacy</b>						<b>B</b>	<b>Improving</b>
Tier 1 Ratio (%) (Basel I)	11.61%						
Tangible Common Equity % RWA (Basel I)			4.98%				
<b>Factor: Efficiency</b>						<b>B</b>	<b>Weakening</b>
Cost / Income Ratio		47.00%					
<b>Factor: Asset Quality</b>						<b>C</b>	<b>Improving</b>
Problem Loans % Gross Loans			3.69%				
Problem Loans % (Equity + LLR)			20.14%				
Lowest Combined Financial Factor Score (9%)						<b>C</b>	
<b>Economic Insolvency Override</b>						<b>Neutral</b>	
<b>Aggregate BFSR Score</b>						<b>C</b>	
<b>Aggregate BCA Score</b>						<b>a3</b>	
<b>Assigned BFSR</b>						<b>C-</b>	
<b>Assigned BCA</b>						<b>baa1</b>	

[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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