

Global Credit Research - 28 Jan 2014

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
Parent: Grupo Aval Acciones y Valores S.A.	
Outlook	Stable
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

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Key Indicators

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

	[2]6-13	[2]12-12	[2]12-11	[2]12-10	[2]12-09	Avg.
Total Assets (COP billion)	86,979.1	80,506.4	68,809.6	59,346.6	36,475.2	[3]24.3
Total Assets (USD million)	45,037.8	45,561.0	35,496.1	30,909.5	17,853.9	[3]26.0
Tangible Common Equity (COP billion)	4,556.0	4,573.5	3,539.4	761.2	2,236.0	[3]19.5
Tangible Common Equity (USD million)	2,359.1	2,588.3	1,825.8	396.5	1,094.5	[3]21.2
Net Interest Margin (%)	5.3	5.3	4.0	3.4	4.2	[4]4.4
PPI / Average RWA (%)	4.9	4.3	5.1	6.9	8.9	[5]6.0
Net Income / Average RWA (%)	2.0	2.0	1.9	2.1	3.0	[5]2.2
(Market Funds - Liquid Assets) / Total Assets (%)	-12.5	-13.9	-11.5	-9.5	-21.0	[4]-13.7
Core Deposits / Average Gross Loans (%)	116.1	120.5	119.3	154.0	124.3	[4]126.8
Tier 1 Ratio (%)	8.0	8.0	7.2	3.5	10.6	[5]7.5
Tangible Common Equity / RWA (%)	5.8	6.3	5.6	1.4	6.6	[5]5.2
Cost / Income Ratio (%)	56.2	60.2	55.9	43.4	41.7	[4]51.5
Problem Loans / Gross Loans (%)	1.2	1.2	1.3	1.6	2.2	[4]1.5

Problem Loans / (Equity + Loan Loss Reserves) (%)	6.5	6.2	6.8	10.9	10.1	[4]8.1
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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 19 July announcement that the bank would make its second acquisition in the year and following the 24 July announcement that its majority shareholder Grupo Aval Acciones y Valores S.A. (Grupo Aval, Baa3 stable) would capitalize the bank with USD500 million to support the acquisitions of Banco Bilbao Vizcaya Argentaria (Panamá), S.A. (BBVA Panamá, unrated) and Guatemala's Grupo Financiero Reformador (Reformador, unrated). Under Moody's scenario analysis and adjusting capital ratios for goodwill and government risk exposures, the bank's Tier 1 capital ratio would have been reduced from an already low level without the commitment to capitalize.

In 18 December 2013, Banco de Bogotá was capitalized with COP1.3 trillion. 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. Further acquisition announcements or other events that affect tangible capital ratios could also prompt negative rating actions.

On 19 December 2013, Banco de Bogotá acquired BBVA Panamá (now 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 its Central American subsidiary BAC International Bank, Inc. (BAC Credomatic, D+/baa3 stable, Baa3 stable), to be completed by mid-2014.

On 23 December 2013, Banco de Bogotá acquired for USD411 million Reformador through Credomatic International Corporation (unrated), a subsidiary of BAC Credomatic.

Though the acquisitions benefit the bank's franchise through a stronger presence in the fast growing Panamanian market, they generate additional goodwill that would have weakened Banco de Bogotá's capital ratios absent the capitalization. The new goodwill is in addition to that associated with the acquisition of BAC in 2010.

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 larger peer bank Bancolombia in Colombia and Central America, and domestically 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 ratings 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 ratings.

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% vs. 5.3% as of September 2013) 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 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 three year-end average preprovision, pre-tax income (PPI) as percent of average RWAs is 5.4% and net income as percent of average RWAs is 2.0%.

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.

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%; these ratios have improved through September 2013 to 1.3% and 6.7%, respectively.

Banco de Bogotá's granularity, measured by top 20 exposures against fully adjusted Tier 1 capital (1.3x as of September 2013) and core earnings (2.2x), is low and could expose the bank to potentially rapid asset quality deterioration, but from very low levels of past due loans.

Capitalization levels are low when compared to regional peers, exhibited by a fully adjusted Tier 1 ratio of 8.0% (grandfathered goodwill is deducted) as of September 2013. 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 expected growth levels, Banco de Bogotá's earnings capabilities and reserves. As such, Moody's expects Banco de Bogotá's forward looking fully adjusted Tier 1 ratio to be an estimated 6.7%.

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, 67.5% of its loans are directed to corporate loans and leases, followed by consumer loans with 23.7% and residential mortgages with 8.3%, as of September 2013.

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 Banco BAC de Panamá and Reformador, the exposure to Panama and Guatemala is expected to increase to 6% and 10%, 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 8.5% of Fully Adjusted Tier 1 capital and eight out of ten board members are considered independent, as of September 2013.

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 (111.6% of gross loans) and ample liquidity (30.1% of total assets), for a liquidity ratio [(market funds - liquid assets)/total assets] of -9.7%, as of September 2013.

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 236% and 39% of adjusted Tier 1 capital, respectively, as of September 2013.

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 USD550 billion. 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 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						D+	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						A	Weakening
PPI % Average RWA (Basel I)	5.41%						
Net Income % Average RWA (Basel I)	2.02%						
Factor: Liquidity						B	Neutral
(Market Funds - Liquid Assets) % Total Assets	-11.64%						
Liquidity Management			x				
Factor: Capital Adequacy						C	Weakening
Tier 1 Ratio (%) (Basel I)			6.23%				
Tangible Common Equity % RWA (Basel I)			4.44%				
Factor: Efficiency						B	Neutral
Cost / Income Ratio		53.15%					
Factor: Asset Quality						B+	Neutral
Problem Loans % Gross Loans		1.39%					
Problem Loans % (Equity + LLR)	7.95%						
Lowest Combined Financial Factor Score (9%)						C	
Economic Insolvency Override						Neutral	
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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