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## Research Update:

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

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## Research Update:

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## Overview

- Colombia-based bank BBogota maintains its leadership in Colombia, while it strengthens its geographic diversification through additional acquisitions in Guatemala and Panama.
- Moderate risk-adjusted capitalization is the bank's main weakness, as a result of aggressive inorganic growth.
- We are affirming our long-term 'BBB-' and short-term 'A-3' issuer credit ratings on the bank.
- We expect BBogota's expansionary strategy will continue to pressure its moderate risk-adjusted capitalization, due to high loan growth rates and increasing goodwill on its balance sheet.

## Rating Action

On Aug. 29, 2013, Standard & Poor's Ratings Services affirmed its global scale long-term 'BBB-' and short-term 'A-3' issuer credit ratings on Banco de Bogotá S.A. y Subsidiarias (BBogota). At the same time we are affirming BBogota's senior unsecured debt at 'BBB-'. The outlook is stable.

## Rationale

The ratings on BBogota reflect our view of its "strong" business position, "moderate" capital and earnings, "adequate" risk position, "average" funding and "adequate" liquidity, as our criteria define these terms. The bank's stand-alone credit profile (SACP) is 'bbb-'.

Under our bank criteria, we use our Banking Industry Country Risk Assessment's (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 'bbb-', reflecting our view of the weighted-average economic risk in the countries to which the bank is exposed through its total loans--Colombia (representing more than 70% of total loans), Costa Rica, Panama, Honduras, El Salvador, Guatemala and Nicaragua. We score BICRAs on a scale of '1' to '10', ranging from the lowest-risk banking systems (group '1') to the highest-risk (group '10'). Our weighted economic risk score for these countries is '6.3'. Given that majority of BBogota's exposure is, and will remain, in Colombia, the bank's anchor is based on the country's economic risk score of '6' and an industry risk score of '5'. Colombia's economic risk reflects its low GDP per capita levels that limit its ability to withstand economic downturns and household credit capacity. It also considers our view

that economic imbalances remain manageable, despite rapid credit expansion over the past few years. We still consider that the risk of an asset price bubble in this market will remain fairly low. However, we believe Colombia is highly vulnerable to a U.S. economic downturn. Our industry risk assessment reflects the financial system's healthy competitive dynamics and its adequate funding structure characterized by a fairly stable core customer deposit base. This is partially offset by a low level of retail deposits and narrow and shallow domestic debt capital markets. The Colombian banking system shows a good level of transparency, and regulatory coverage is adequate. However, there are still areas to develop such as capitalization rules and a more risk preemptive regulatory framework.

BBogota's business position remains "strong" in our view. This reflects the bank's good market position in Colombia and in the Central American countries where it has expanded its participation. In our view, its geographic expansion supports business stability and diversification by revenues and lines of business. Grupo Aval Acciones y Valores S.A. (Grupo Aval; not rated), is BBogota's ultimate parent, and enjoys a well-recognized brand and large network which allows BBogota to provide its banking services throughout Colombia.

BBogota maintains its leadership in Colombia and in the Central American countries in which the bank operates. As of June 2013, it was the second-largest bank in Colombia, with a total loans market share of 12.8%. This bank participates in all banking segments; however, it has historically focused on the commercial segment with a market share of about 18% in Colombia. This line of business represents about 80% of BBogota's total loans in Colombia however the participation drops to 63% if we consider the bank's consolidated figures, which include exposure to Central America. At year-end 2012, BBogota's loan portfolio consisted of commercial loans (63.2%), consumer loans (23.9%), microlending (0.5%), mortgages (7.6%) and financial leasing (4.8%). The exposure of the bank to Central America represents about 30% of its total loans on a consolidated basis, and it maintains a good market position in all these countries with market shares above 10%, except for Guatemala and Panama. However, with BBogota's recent announcement that it would acquire Grupo Reformador in Guatemala (not rated), for an estimated \$411 million, and BBVA Panama in Panama (BB+/WatchDev/B), for \$490 million, we expect BBogota's market position to increase importantly in those countries, to levels close to 10% in Guatemala and 6% in Panama, in terms of loans.

Colombia operations represent the majority of BBogota's business and we do not expect changes in this respect. In our view, the current macroeconomic environment in Colombia--GDP is likely to grow about 4% in 2013, GDP per capita is rising and there is low inflation--makes this market attractive for continued growth, as it provides stability to BBogota's results. Loans distribution by country is consistent with the distribution of revenues; about 74% of the revenues are located in Colombia. We do not expect further inorganic growth in the short-term; we believe the bank will focus on consolidating its recent acquisitions.

We assess BBogota's capital and earnings as "moderate." We believe the announced acquisitions of Grupo Reformador and BBVA Panama will pressure the bank's capitalization as they will increase BBogota's risk weighted assets, and also because of the goodwill that these transactions will bring to BBogota's balance sheet. However, Grupo Aval announced it will inject up to \$500 million in capital into BBogota in order to maintain its capitalization ratios relatively stable once the transactions are completed and incorporated on its balance sheet. BBogota would raise these funds through an IPO. We do not expect the acquisitions to significantly weaken the bank's risk-adjusted capital ratio (RAC) which was 5.6% at year-end 2012. According to our base-case scenario BBogota's RAC ratio should be about 5.1% during the next 12-18 months. This scenario considers the following assumptions:

- Estimated BBogota's loan growth of about 32% in 2013 and 18% in 2014. We are incorporating in 2013 the acquisition of Grupo Reformador and BBVA Panama and natural organic growth.
- No additional acquisitions in 2014;
- A capital injection in BBogota for up to \$500 million, which would take place in the second-half of 2013;
- \$566 million of additional goodwill on BBogota's balance sheet, as of 2013 as a consequence of both acquisitions;
- BBogota's net interest margin will be about 6%; efficiency levels--measured by non-interest expenses to operating revenues--should remain at about 60%; and return on assets (ROA) above 1.5%;
- Similar asset quality metrics, with nonperforming assets (NPAs) of about 2.5% fully covered by reserves, and charge-offs (without considering recoveries) at about 1%;
- Credit loss provisions to represent less than 10% of BBogota's operating revenues during 2013 and 2014; and
- Projected dividend payout ratio of about 40% for 2013 and 2014.
- Our projected RAC ratio also reflects a significant charge for equity in the banking book, due to the bank's equity investments in its subsidiary Corporación Financiera Colombiana S.A. (Corficolombiana; not rated), which are incorporated in our risk-weighted assets.

We still assess BBogota's risk position as "adequate" due to its good underwriting practices, reflected in relatively low and stable credit losses; its adequate risk diversification also supports the bank's risk position. BBogota maintains its adequate diversification by economic sector and does not have significant concentrations by individual borrower. The top 20 customers' participation within the bank's total loans is declining; as of June 2013, these represented about 12% of the bank's loan portfolio, compared to 16% at year-end 2011. This improvement reflects the boost in retail loans participation within BBogota's consolidated loan portfolio. In addition, the top 20 borrowers represent about 50% of BBogota's total equity, which compares positively with other regional peers who have higher concentrations.

The bank continues to have a satisfactory loss experience, as it did during the recent economic slowdown in Colombia. The bank's recovery levels are very good and have been consistently higher than its charge-offs as net charge-offs

have been negative for the past few years. In our opinion, this reflects the adequate charge-off policy established by the Colombian regulator; for instance, commercial loans are charged-off after 360 and mortgages after 1,620 days. Before the bank applies a charge-off, the loan needs to have a 100% provision. Of the consumer segment--including mortgages-- represents a higher participation within the bank's loan portfolio, net charge-offs could become positive, given that retail loans are more difficult to recover. However, we do not expect significant changes for the bank's net charge-offs in the next two years. During the past four years, net charge-offs have represented negative 0.7% of total loans.

In our view, BBogota's funding is "average" within the Colombian banking system, as it finances most of its operations with its deposits; during the past three years the bank's loan-to-deposits ratio has averaged 88%. BBogota's core deposits represent about 77% of its total funding base; demand deposits represent more than 60% of the total. BBogota maintains its good market position with respect to deposits, 14.3% as of June 2013. During the first-quarter of 2013, the bank issued a 10-year subordinated bond up to \$500 million; however, its market debt still represents a low less than 5% participation in BBogota's funding base. Although we believe the bank has sufficient flexibility to increase its wholesale funding in order to support future growth, core customer deposits will likely continue to represent a large share of the bank's funding base, while it maintains a healthy loans-to-deposits ratio. All these factors contribute to BBogota's stable and relatively low funding costs.

We believe BBogota has relatively low retail deposits participation within its total deposit base with respect to its regional peers (14% as of June 2013); however, this is common for the Colombian banking system with retail deposits representing 23% systemwide. However, in Central America retail deposits could be much higher; as 40% of BAC International Bank Inc.'s (BAC; BBogota's subsidiary), total deposit base is made up of retail deposits, which we deem as more stable. Despite the large participation of wholesale deposits within BBogota's total deposit base, the top 20 depositors represent around 14% of the bank's total deposits. In our view, this factor relieves pressure on funding risk concentrations. BBogota has maintained a stable and favorable funding ratio, averaging 115% for the last three years. This factor also supports our assessment of the bank's "average" funding. We expect growth in other funding sources; however, we believe the bank will maintain its current funding mix.

BBogota's liquidity is "adequate" reflecting satisfactory cash management and local regulatory standards, which closely follow liquidity gaps in all the banks in the system on a weekly basis. The BBogota's broad liquid assets to short-term wholesale funding has remained greater than 2.5x during the last three years, and this ratio is in line with its national peers.

Although the likelihood of extraordinary government support of BBogota is "moderately high," the bank's issuer credit ratings do not reflect notches of government support. However, if we were to lower BBogota's stand-alone credit

profile ('bbb-') by one notch because of a drop below 5% in its RAC ratio, its issuer credit rating would remain at 'BBB-' reflecting one notch of government support.

## Outlook

The stable outlook on BBogota reflects our expectation that the bank's expansion strategy will continue to pressure its risk-adjusted capitalization levels. Despite the recently announced up to \$500 million capital injection, our RAC ratio will remain moderate, basically due to high growth rates projected for 2013 and 2014 (32% and 18%, respectively), and by the additional \$566 million of goodwill from its new acquisitions. We expect BBogota's RAC ratio to be about 5.1% during the next 12-18 months. The outlook also believes that its increasing leadership in Colombia and its good geographic diversification support the bank's business position. We believe BBogota will maintain adequate asset quality metrics, reflecting its good origination practices--NPAs are expected to be about 2.5% during the next 12-18 months, fully covered by reserves.

At this point, we are not incorporating notches of government support to BBogota's issuer credit ratings because of its 'bbb-' SACP and Colombia's local-currency long-term rating (BBB+). However, if its SACP deteriorates by one notch to 'bb+', due to a fall in its RAC ratio to below 5.0% or if its risk position deteriorates, the bank's issuer credit rating would remain at 'BBB-' given that it would reflect one notch of government support. In this sense, we do not expect a downgrade in the short-term.

On the other hand, we do not expect either an upgrade of BBogota in the short-term as we believe the bank's business and risk positions will remain unchanged, as well as its funding and liquidity factors.

## Ratings Score Snapshot

Issuer Credit Rating	BBB-/Stable/A-3
SACP	bbb-
Anchor	bbb-
Business Position	Strong (+1)
Capital and Earnings	Moderate (-1)
Risk Position	Adequate (0)
Funding and Liquidity	Average / Adequate (0)
Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

## Related Criteria And Research

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment: Colombia, Nov. 30, 2012
- Banks: Bank Capital Methodology and Assumptions, Dec. 6, 2010

## Ratings List

Ratings Affirmed

Banco de Bogota S.A. y Subsidiarias

Counterparty Credit Rating	BBB-/Stable/A-3
Senior Unsecured	BBB-

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