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Research Update:

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

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Overview

- Colombia-based universal bank BBogota holds a strong market position in Colombia and in most Central American countries where the bank has presence, as well as in the business segments in which it participates.
- The bank's moderate risk-adjusted capitalization remains its main weakness.
- We are affirming our long-term 'BBB-' and short-term 'A-3' issuer credit ratings on the bank.
- The stable outlook reflects BBogota's strong market position and expertise, which support its business stability. Its prudent underwriting standards will allow the bank to maintain healthy asset quality metrics in light of the challenging credit conditions in Colombia and in Latin America.

Rating Action

On Aug. 31, 2015, Standard & Poor's Ratings Services 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 stable.

Rationale

The issuer credit ratings on BBogota continues to reflect its "strong" business position (seen in its leading position in most of the countries where it is present), its "moderate" capital and earnings (evidenced by its forecasted risk-adjusted capital [RAC] ratio of barely 5.0%), "adequate" risk position (reflected in its sustained healthy asset quality metrics), "average" funding (supported by its large and stable deposit base), and "adequate" liquidity. The stand-alone credit profile (SACP) remains 'bbb-'.

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic 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 61% 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 '6.4'. 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 the country's low-income levels, which constrain its economic resilience, and reflect our "high risk" assessment for credit risk in the economy, as households have lower capacity to take out credit lines and are more vulnerable to economic downturns. On the other hand, Colombia has low inflation, moderate fiscal and current account deficits, a floating exchange rate, and a strong political consensus on key economic policies. These factors should maintain policy stability and economic resilience in the coming years. Colombia still has manageable economic imbalances--in our view, relatively fast credit expansion and rising housing prices pose an "intermediate risk" for the financial system. Still, the country's banking sector has sound asset quality and good underwriting standards, especially in the mortgage market.

Our industry risk score of '5' reflects no significant distortions in the financial system, banking industry's stability, and a satisfactory deposit base that has remained fairly stable even during periods of market turmoil. On the other hand, we believe there is room for improvement in Colombia's regulatory framework and track record, in particular with regard to capitalization rules. On the positive side, transparency in the financial system is very good and compares favorably with many of its peers in the region.

We still assess BBogota's business position as "strong," based on its leadership in Colombia and in the Central American countries in which it operates through its core subsidiary BAC International Bank Inc. (BIB; BBB-/Stable/A-3). Our assessment also highlights the bank's above-average geographic and product diversification that provide stability to its operating revenues. As of March 31, 2015, BBogota is the second-largest bank in Colombia, with a market share of 14% by total loans, just behind Bancolombia (BBB-/Stable/A-3) which has a 23% market share. As a universal bank, BBogota participates in all banking segments; however, it has been historically focused on the commercial segment, where it holds a market share of 18.8% in Colombia as of March 31, 2015. The bank's exposure to Central America is increasing and represents about 38% of its total loans, and it has a market share above 10% in each of those countries, with the exception of Panama. We expect BIB's total loans will represent about 40% of BBogota's loan portfolio during the next two years.

BBogota has maintained its efforts to improve its business diversification both geographically and by business activity. In this sense, its exposure to the consumer segment has been on the rise and the bank keeps strengthening its participation in other countries in Central America, currently through organic growth. As of March 31, 2015, BBogota's loan portfolio is composed of commercial loans (60.1%), consumer loans (24.9%), microlending (0.4%), mortgages (10.7%) and financial leasing (3.9%). Looking forward, we believe

BBogota's consolidated loan portfolio will remain relatively stable, with slightly higher participation in consumer loans and mortgages, reflecting the constant growth in Central America.

We expect BBogota's total loans to grow about 17% in 2015 and 2016, on average. We believe its highest exposure will remain in Colombia--about 60%--during that timeframe. Further, the distribution of loans by country is consistent with the distribution of revenues: about 61% of revenues are located in Colombia. The bank's good geographic diversification provides stability in the event of adverse economic developments. We do not expect further inorganic growth in the short-term; we believe the bank will instead continue to focus on consolidating its recent acquisitions.

Our assessment on BBogota's capital and earnings remains "moderate." This reflects our projected RAC ratio, which we expect to stand slightly above 5.0% during the next two years, as well as the good quality of the bank's capital (the absence of hybrid capital instruments) and earnings (with good profitability metrics). Our financial forecasts take into consideration our base-case scenario assumptions, which include:

- Colombian GDP growth of 3.0% in 2015, 3.5% in 2016 and 4.0% in 2017;
- Consolidated loan portfolio growth of about 17% in 2015 and 2016, on average, and 19% in 2017;
- We expect net interest margins (NIMs) to gradually increase, reflecting the growing participation of small and medium enterprises (SMEs) and consumer loans in BBogota's consolidated loan portfolio;
- We believe BBogota's profitability metrics will remain stable during the next two years, with return on assets (ROA) of about 1.5% and improving efficiency--measured by non-interest expenses to operating revenues--standing at about 55% during this timeframe. Additionally, we expect credit loss provisions to represent about 12%-15% of operating revenues;
- Nonperforming assets (NPAs--nonperforming loans after 90 days plus repossessed assets) to total loans ratio standing at about 1.6% during the next two years, fully covered by reserves, and net charge-offs representing less than 1% of total loans.
- We are projecting relatively stable goodwill, as we do not expect additional acquisitions during the next two years. We believe that pressure on goodwill from the depreciation of the local currency might be somewhat offset by natural amortization of this intangible asset;
- We expect a dividend payout ratio of about 45% in 2015 and 2016.

During 2014, BBogota's RAC was supported by to its internal capital generation capacity and a capital injection of up to Colombian peso(COP)1.500 trillion (equivalent to $600 million) that took place in December 2014. These factors somewhat offset the bank's rapid credit growth in 2014, as well as the increasing goodwill related to the strong depreciation of the local currency (about 60% during the past 12 months) and higher-than-average dividend payout ratio. In our view, BBogota's RAC ratio will remain sensitive to further Colombian peso depreciation during 2015, considering the large participation of goodwill within its total adjusted capital (TAC--estimated at 40%) and given that most of the goodwill is denominated in foreign currency. In this sense, we'll be closely monitoring the bank's RAC ratio in order to determine if our capital and earnings assessment can remain in the "moderate" category. If the RAC ratio falls below this category, we could revise our assessment downward and, consequently, lower its SACP.

BBogota's quality of capital and earnings remains "adequate,"]reflecting its sound profitability metrics, putting the bank in a good position compared to its regional and global peers. The absence of hybrid capital instruments within our estimated TAC also supports our assessment. Additionally, BBogota's quality of earnings reflects its sound diversification in terms geography and product. In the future, we expect that 60% of total revenues will come from Colombia and 40% from Central America. In our view, BBogota's profitability levels will be supported by the bank's efforts to improve efficiency during the next two years.

BBogota's "adequate" risk position is based on the bank's conservative risk management, allowing it to maintain healthy asset quality metrics, including low credit losses. The bank's adequate risk diversification remains a positive for its overall risk position.

BBogota's loan portfolio has been growing at high rates, but we expect this trend will moderate during 2015 and 2016, considering weaker domestic demand and the impact of lower oil prices that would result in slower economic growth. However, we still believe BBogota will continue to show above average growth rates relative to the Colombian banking system (which we expect to growth around 13%-13.5% by year-end 2015, picking up to 14%-15% in 2016). In our view, aggressive growth under weakening credit conditions in Colombia and Latin America could result in deteriorating asset quality metrics, and this could put pressure on the bank's risk position. However, we believe BBogota will maintain its conservative underwriting standards, allowing them to navigate choppy waters through the next 12-18 months.

BBogota maintains adequate diversification by individual debtor; as of March 31, 2015, the bank's top 20 customers represented 8.7% of its loan portfolio and this participation remains relatively stable. In addition, its top 20 borrowers represent about 55% of BBogota's total equity; this level compares positively against other peers in the region with higher concentrations. In our view, BBogota will continue increasing its participation in the consumer and mortgage segments, but this will happen in a gradual and conservative fashion. In this sense, we do not expect significant changes in its risk concentrations.

Its asset quality metrics remain adequate in comparison with local and global peers. NPAs averaged 1.4% during the last three fiscal years and remained at that level during the first quarter of 2015, standing below the average of the Colombian banking system (1.9%). Moreover, NPAs remain fully covered by reserves-- 2x on average during the last three fiscal years. We are forecasting NPAs to be around 1.6% during the next two years, as we believe that the combination of a rapid credit expansion and low household income levels could result in higher credit risk in the Colombian economy. Despite the strong depreciation of the Colombian peso with respect to the U.S. dollar during the past 12 months, we believe that the low participation of total loans denominated in foreign currency (14% as of March 31, 2015) will allow it to limit corrosion in its asset quality metrics. BBogota's net charge-offs were marginal with respect to total loans (0.14% in 2014). Looking forward, we believe credit losses will remain low during next two years, standing below 1%.

We still assess BBogota's funding as "average" when compared to the industry norm. Its funding structure—which is mainly composed of deposits (71% of total liabilities as of March 31, 2015)—supports our assessment. The remaining 29% of the bank's liabilities are mainly interbank loans (13%), repurchase agreements (5%) senior unsecured bonds (2%), and subordinated bonds (2%). Most of BBogota's deposits are time deposits (45% of the bank's total deposits). In terms of deposit concentration, its top 20 depositors accounted for about 20% of Bogota's total consolidated deposit base as of first-quarter 2015 (16% as of March 31, 2014), reflecting a lower-than-average retail deposit base compared to its Latin American peers'.

The bank's adequate funding structure rests on its satisfactory stable funding ratio (SFR), reflecting its ample deposit base. Its SFR stood at 114.5% as of December 2014 and has averaged 114.5% for the past three fiscal years. Given our expectations for its stable funding needs and funding structure over the next two years, we anticipate its SFR will remain above 100%, which we view as adequate. We believe this figure will continue to compare adequately with the Colombian banking system as a whole.

BBogota's coverage of short-term wholesale funding with liquid assets underpins our assessment of its "adequate" liquidity. Its comfortable debt maturity profile further supports its liquidity. Our broad liquid asset to short-term wholesale funding ratio stood at 2.8x as of Dec. 31, 2014 with a three-year average of 2.6x. BBogota's short-term wholesale funding is low--representing 12% of its funding base--and supported by manageable refinancing risk over the next 12 months. The bank's outstanding market debt is mostly issued in foreign currency; however, this debt represents a low 2% of total liabilities and is, for the most part, set at fixed rates. Moreover, the maturity profile of its market debt is comfortable in our opinion. Like other Colombian banks, BBogota has maintained higher-than-average liquidity ratios in order to offset the high participation of wholesale deposits within its deposit base. The bank's main subsidiary, BAC, is a very liquid entity because of the lack of a lender of last resort in Panama and El Salvador. We anticipate adequate liquidity management going forward.

We still believe BBogota has a "moderately high" likelihood of extraordinary government support; however, the bank's issuer credit ratings do not reflect notches of government support. If we were to lower BBogota's SACP (currently at '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 reflects our expectation that the bank will remain a leading player in Colombia and Central America, while maintaining its adequate and prudent risk profile. It will do so by sustaining its healthy asset quality metrics--with projected NPAs and gross charge-offs to total loans of about 1.6% and less than 1%, respectively, over the next two years. Its still-moderate RAC ratio also supports our outlook assessment. We believe BBogota's funding and liquidity profiles will continue to benefit from a well-established deposit franchise, though its dependence on wholesale funding is fairly high, much like the Colombian banking system.

At this point, we are not incorporating notches of government support into our assessment of the issuer credit ratings on BBogota because of its 'bbb-' SACP and Colombia's local-currency long-term rating (BBB+).If BBogota's TAC is continuously pressured by its increasing goodwill--due to the deep depreciation of the Colombian peso with respect to the U.S. dollar--resulting in a weaker RAC ratio (below 5.0%), we will revise its SACP downward by one notch to 'bb+'. Deterioration in the bank's risk position would also weaken its SACP. However, if BBogota's SACP drops to 'bb+', the 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 an upgrade of BBogota in the short-term as we believe the bank's business and risk positions will remain unchanged, and that its funding and liquidity will remain stable.

Rating 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 and Adequate (0)
Support	0
GRE Support	0
Group Support	0
Government Support	0

Additional Factors	0

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Capital Methodology and Assumptions, Dec. 6, 2010

Related Research

- Credit Conditions: Latin America Navigates Choppy Waters Through 2015, July 14, 2015
- Economic Slump Will Largely Bypass Large Latin American Banks But May Take A Toll On Their Smaller Peers, July 9, 2015
- Supplementary Analysis: Republic of Colombia, July 31, 2015
- A Cloudy Economic Forecast Still Overshadows Latin American Banks, June 16, 2015
- Top Colombian Banks, Oct. 28, 2014

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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