

CREDIT OPINION

28 July 2020

Update

 Rate this Research

RATINGS
Grupo Aval Acciones y Valores S.A.

| | |
|-------------------------|------------------------------------|
| Domicile | Bogota, Distrito Capital, Colombia |
| Long Term CRR | Not Assigned |
| Long Term Issuer Rating | Not Available |
| Type | Not Available |
| Outlook | Negative |

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Grupo Aval Acciones y Valores S.A.

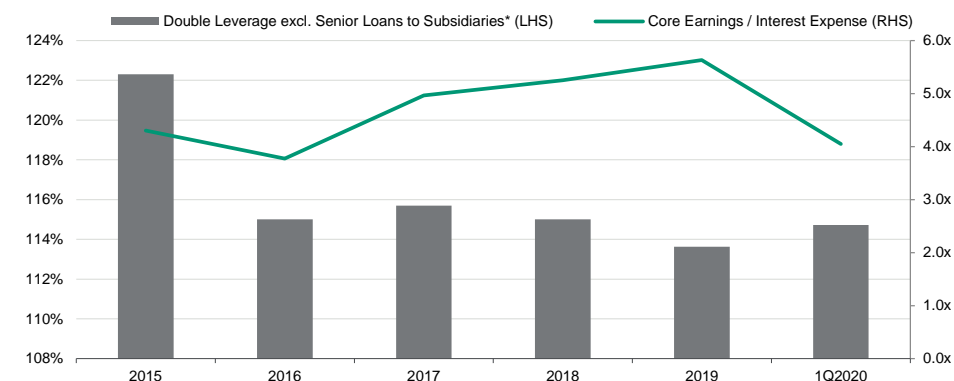
Update to credit analysis

Summary

[Grupo Aval Acciones y Valores S.A.](#)'s (Grupo Aval) Ba2 issuer rating reflects the structural subordination of the bank holding company's liabilities versus the liabilities of the bank and its other subsidiaries, and is notched off [Banco de Bogotá S.A.](#)'s (Banco de Bogotá, Baa2 negative, ba1)¹ Baseline Credit Assessment (BCA). While Grupo Aval has multiple financial subsidiaries that include banks in Colombia, a merchant bank, a pension and severance fund manager, and a Central American banking group, its negative outlook incorporates the downward pressure on Banco de Bogotá's BCA, reflected in its own negative outlook. Banco de Bogotá is the group's chief operating entity, which booked 67% of gross loans and 63% of dividends of the consolidated group as of March 2020. The acquisition of Panama-based Multi Financial Group (MFG), closed on 22 May 2020, will add \$5 billion to Banco de Bogotá's total assets². We do not incorporate government support into the holding company's ratings.

We also assign a Ba2 rating to Grupo Aval's foreign-currency senior debt notes issued through Grupo Aval Limited, its subsidiary in the Cayman Islands. The senior debt ratings are based on Grupo Aval's irrevocable and unconditional guarantee of Grupo Aval Limited's liabilities under the indentures.

Exhibit 1

Debt service and leverage ratios
Leverage remains stable, while debt servicing remains adequate


*Investments in subsidiaries, goodwill and subordinated loans to subsidiaries as a percentage of shareholders' equity, excluding asset revaluations.

Source: Moody's Investors Service

Credit strengths

- » Ample and sound volume of dividend inflow from subsidiaries
- » Diversified source of earnings through multiple financial subsidiaries, including banks in Colombia, a merchant bank, a pension and severance fund manager, and a Central American banking group
- » Sufficient holding of liquidity and interest income in dollars, limiting the entity's reliance on dividend inflows to meet upcoming debt obligations

Credit challenges

- » Main operating subsidiary challenged by the more volatile and weaker operating environment in Central America
- » The structural subordination of the bank holding company's liabilities to those of its highly regulated operating entities

Outlook

The negative outlook on Grupo Aval's ratings incorporates the downward pressure on Banco de Bogota's BCA, reflected in its own negative outlook.

Factors that could lead to an upgrade

- » Upward pressure on Grupo Aval's ratings would be associated with similar pressures on Banco de Bogota's BCA; currently, upward pressures are limited.
- » However, Grupo Aval's ratings could return to stableif and when Banco de Bogotá's ratings were stabilized following an improvement in the economic environment in Central America or if the bank is capable of maintaining its current asset quality, along with profitability, as measured by net income/tangible banking assets, above 2.0% on a sustained basis.

Factors that could lead to a downgrade

- » Debt issuances or further acquisitions by the group or its subsidiaries, resulting in a sustained deterioration in the double leverage ratio, would trigger a reassessment of the notching differential between Banco de Bogotá's BCA and Grupo Aval's issuer and debt ratings.
- » A lower BCA for Banco de Bogotá could have a similar effect on the ratings, which could materialize if the current negative outlook translates into a deterioration in the bank's financial performance. More specifically, if the bank were to experience a substantial deterioration in asset quality, which would lead to a sustained deterioration in its profitability.

Profile

Grupo Aval Acciones y Valores S.A. (Grupo Aval) is the largest financial conglomerate in Colombia, with COP320.4 trillion in total assets (\$79 billion) as of March 2020. The group owns the third-largest (Banco de Bogotá S.A. [Banco de Bogotá], 12.3%), fifth-largest (Banco de Occidente S.A. [Banco de Occidente], 6%), seventh-largest (Banco Popular S.A. [Banco Popular], 4.1%) and 10th-largest (Banco Comercial AV Villas S.A., 2.4%) banks in the country in terms of loans. Grupo Aval also has geographic and industry diversification through Banco de Bogotá's [BAC International Bank, Inc.](#) (BAC, Ba1 stable, ba1), a universal bank present throughout Central America; Corporación Financiera Colombiana S.A., Colombia's largest merchant bank; and the ownership of the country's largest private pension fund manager, AFP Porvenir S.A. (Porvenir).

Together, Grupo Aval's banks constitute the second-largest franchise in Colombia, with a combined market share of about 24.8% of the financial system's loans as of March 2020. The group has around 16 million clients in Colombia and Central America, with a network of 1,692 branch offices and 5,671 ATMs.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key Indicators

Exhibit 2

Grupo Aval Acciones y Valores S.A. (Consolidated Financials) [1]

| | 1Q 2020 | 2019 | 2018 | 2017 [5] | 2016 [5] | Average |
|--|---------|--------|--------|----------|----------|---------|
| Total Assets (COP Billion) | 31,174 | 25,796 | 23,566 | 21,949 | 20,884 | 24,674 |
| Investments in Subsidiaries (COP Billion) | 21,397 | 21,776 | 19,580 | 18,197 | 17,108 | 19,612 |
| Loans to Subsidiaries (COP Billion) | 2,787 | 1,959 | 1,886 | 2,064 | 2,184 | 2,176 |
| Total Debt (COP Billion) | 9,764 | 4,980 | 4,924 | 4,657 | 4,467 | 5,758 |
| Shareholders' Equity (COP Billion) | 19,931 | 20,335 | 18,222 | 16,838 | 15,985 | 18,262 |
| Core Earnings (COP Billion) [2] | 394 | 1,557 | 1,360 | 1,355 | 1,351 | 1,203 |
| Interest Expense (COP Billion) | 97 | 276 | 259 | 273 | 358 | 253 |
| Double Leverage excl. Senior Loans to Subs [3] | 114.7% | 113.6% | 115.0% | 115.7% | 115.0% | 114.8% |
| Debt / Core Earnings [4] | 6.2x | 3.2x | 3.6x | 3.4x | 3.3x | 4.0x |
| Core Earnings / Interest Expense | 4.0x | 5.6x | 5.3x | 5.0x | 3.8x | 4.7x |

[1] Grupo Aval + Grupo Aval Limited unconsolidated data. [2] Includes cash flow from dividends, investments and net operating cash inflows; IFRS. [3] Investments in subsidiaries, goodwill and subordinated loans to subsidiaries as a percentage of shareholders' equity excluding asset revaluations. [4] Core earnings have been annualized for comparability. [5] Total Assets and Shareholders' Equity exclude revaluations (IAS 27 rule (IFRS))

Source: Moody's Investors Service; Company Filings

Detailed credit considerations

Structural subordination

Grupo Aval's Ba2 issuer rating reflects the structural subordination of the bank holding company's liabilities to the liabilities of its highly regulated operating entities, particularly Banco de Bogotá. The differential takes into account the fact that not all resources flowing up from the operating entities to Grupo Aval may be available in the event of stress. However, the upstreaming of dividends has been consistent across all subsidiaries. Furthermore, Grupo Aval maintains a diversified banking operation and does not only rely on income from its equity method interest. The group also has other sources of income, such as the proceeds from the loans that it has granted to its operating entities and the fees that it charges to their banks for the services it provides to them.

In 2012, we rated Grupo Aval's 10-year foreign-currency senior unsecured notes of \$1 billion — issued through Grupo Aval Limited, its subsidiary in the Cayman Islands — Ba2 with a negative outlook. The debt rating take into consideration the fact that the cash flow used to pay the coupons of this issuance relies on the performance of the loans granted with the proceeds of this issuance to its operating companies, and put this flows at the same level of any other interest payment of other financial obligation of any given Grupo Aval's subsidiary.

In January 2020, we also assigned a Ba2 foreign-currency-backed debt rating to the proposed US dollar-denominated senior unsecured notes to be issued by Grupo Aval Limited, with maturities of up to 10 years. The backed debt is irrevocably and unconditionally guaranteed by Grupo Aval. The outlook on the backed debt issuance is negative.

Financial strength depends on Grupo Aval's sound dividend income

Grupo Aval has a strong history of dividend income from its subsidiaries. The group is a bank holding company controlling a diversified, multi-branded group of banks that target different segments of the financial market in Colombia. The main source of dividend has been its flagship bank, Banco de Bogotá. In 2019, Banco de Bogotá was responsible for providing 64% of the total dividends declared to Grupo Aval, which represented a moderate payout ratio of 46.5% of the bank's net income. The second-most important provider of dividends to Grupo Aval was Banco de Occidente with 15.4%, followed by Banco Popular with 8.9%.

The acquisitions made over time by Grupo Aval have strengthened the franchise of its existing operating entities and have resulted in an increase in goodwill. Banco de Bogotá's acquisition of Guatemala's Grupo Financiero Reformador and Banco BAC de Panamá (both completed in December 2013) strengthened BAC's market presence in two key growth markets in the region. The acquisition of BBVA Horizonte AFP S.A. in Colombia added a significant market share to Porvenir, assured Porvenir's dominance in the administration of

the mandatory pension funds and severance funds in Colombia, and strengthened its position as the third-largest provider of voluntary pensions.

However, the bottom-line results generated by the group's operating companies have been affected by specific problematic credit exposures, such as Electrificadora del Caribe S.A. E.S.P. (Electricaribe), a distressed electricity distribution company that is one of the largest corporate borrowers in the country's banking system; Concesionaria Ruta del Sol S.A.S. (CRDS), a highway construction project that will connect Bogotá with the Colombian ports on the Atlantic Coast and in which the group had a minority interest; and certain companies related to Bogotá's mass transportation system, Sistema Integrado de Transporte Público (SITP).

As of December 2019, reserve coverage and the provisioning strategy for these credits were as follows: (1) SITP (total exposure: \$126 million): Grupo Aval has provisioned 25% of the exposure, which can change depending on the development of the restructuring plan for the projects; and (2) CRDS (\$232 million): Grupo Aval has covered 100% of the total exposure. In addition, during 4Q of 2019, the group charged off its exposures to Electricaribe and one of the SITP companies (Tranzit S.A.) that had outstanding debt amounts of \$240 billion and \$32 billion, respectively. Both exposures were already impaired, as there were no expectations of recovery.

Moreover, in Q1 2020, the group started to book provisions for its exposure to Avianca Holdings because the company filed a voluntary request to reorganize under the Chapter 11 of the Bankruptcy Code of the US. The group had provisioned 10% of the \$185 million exposure as of March 2020.

In addition, Grupo Aval may have potential contingencies as it has been charged for three alleged violations to the Colombian free competition regime associated to the project³. Fines could amount up to \$70 million, or around 8% of 2019's net income.

Double leverage ratio is stable, with ample interest coverage

The more a bank holding company relies on debt to fund the equity in its subsidiaries, the greater the structural subordination imposed on holding company creditors.

Our calculation of double leverage includes investments in subsidiaries at book value, subordinated loans to subsidiaries and goodwill as a percentage of shareholders' equity (excluding asset revaluations). Grupo Aval's double leverage was 115% as of March 2020, stable over the past few years. We also consider double leverage high when it remains above the 115% threshold by a significant amount on a sustained basis. At the same time, the company's coverage is high because its core earnings represent 4.0x its interest expenses.

In May 2020, Grupo Aval announced that Banco de Bogotá — through its subsidiary Leasing Bogotá S.A. Panamá — agreed to amend the purchase agreement for up to 100% of the outstanding common shares of MFG, the parent company of Panama's Multibank. The parties mutually agreed to amend the stock purchase agreement after certain previous conditions were not met in a timely manner. Therefore, the agreed price was reduced by 39%, from 1.3x MFG's total shareholders' equity at closing (includes \$110 million represented in preferred shares) to around 0.85x the estimated total shareholders' equity at closing (including the \$110 million in preferred shares).

In June 2020, BAC's early cancellation of a \$180 million subordinated loan granted by Grupo Aval in 2013 benefitted the stability of the double leverage ratio at 115%, which otherwise would have risen to about 120%, driven by the entire purchase of BAC's \$500 million Additional Tier I issuance to finance MFG acquisition in April 2020.

Strong governance reduces the risks arising from family ownership

We acknowledge the depth strength and track record of Grupo Aval's professional management at all levels. The group and its subsidiaries maintain sound risk management policies and best practices, supported by experienced management teams at both the holding and operating entity levels.

The controlling family has the right to elect a majority of the directors and executive officers, and set management policies, which have proved effective over time, reducing the risks arising from potential corporate governance risks. The controlling shareholders have also proved to be willing supporters of the group in the event of stress.

Under the Colombian Financial Conglomerates Law, which came into force in February 2019, Grupo Aval came under the supervision of the Colombian banking regulator. In addition, Grupo Aval is registered and regulated under Colombia's National Registry of Shares and

Issuers, and the US Securities and Exchange Commission, and is required to comply with corporate governance and periodic reporting requirements. Grupo Aval is traded on the NYSE under the ticker AVAL.

Support and structural considerations

Foreign-currency debt rating

We rate Grupo Aval's 10-year foreign-currency senior unsecured notes of \$1 billion (coupon of 4.75%) — issued through Grupo Aval Limited (its subsidiary in the Cayman Islands) — Ba2⁴. The Ba2 long-term foreign-currency debt rating is based on Grupo Aval's irrevocable and unconditional guarantee of Grupo Aval Limited's liabilities under the indentures.

In January 2020, we assigned⁵ a Ba2 foreign-currency-backed debt rating to the proposed US dollar-denominated senior unsecured notes to be issued by Grupo Aval Limited, the Cayman Islands subsidiary of Grupo Aval, with maturities of up to 10 years. The backed debt is irrevocably and unconditionally guaranteed by Grupo Aval. The outlook on the backed debt issuance is negative.

Ratings

Exhibit 3

| Category | Moody's Rating |
|---|------------------|
| GRUPO AVAL ACCIONES Y VALORES S.A. | |
| Outlook | Negative |
| Issuer Rating | Ba2 |
| ST Issuer Rating | NP |
| BAC INTERNATIONAL BANK, INC | |
| Outlook | Stable |
| Counterparty Risk Rating | Baa3/P-3 |
| Bank Deposits | Ba1/NP |
| Baseline Credit Assessment | ba1 |
| Adjusted Baseline Credit Assessment | ba1 |
| Counterparty Risk Assessment | Baa3(cr)/P-3(cr) |
| BANCO DE BOGOTA S.A. | |
| Outlook | Negative |
| Counterparty Risk Rating | Baa2/P-2 |
| Bank Deposits | Baa2/P-2 |
| Baseline Credit Assessment | ba1 |
| Adjusted Baseline Credit Assessment | ba1 |
| Counterparty Risk Assessment | Baa2(cr)/P-2(cr) |
| Senior Unsecured | Baa2 |
| Subordinate | Ba2 |
| GRUPO AVAL LIMITED | |
| Outlook | Negative |
| Bkd Senior Unsecured | Ba2 |

Source: Moody's Investors Service

Endnotes

- 1 The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating (where available) and Baseline Credit Assessment.
- 2 Please see our release titled [Moody's affirms Banco de Bogotá and Aval's ratings, following acquisition announcement; outlook negative](#).
- 3 For further details on the violations, please see Grupo Aval's earnings transcript of [September 2018](#).
- 4 See Moody's Press Release [Moody's assigns issuer and debt ratings to Grupo Aval](#), published on 17 January 2012.
- 5 See our Press Release [Moody's rates Ba2 Grupo Aval's proposed senior unsecured notes; affirms ratings, outlook negative](#), published on 17 January 2020.

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