

Global Credit Research - 16 Jun 2015

Bogota, Colombia

## Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Ba1
ST Issuer Rating	NP
<b>BAC International Bank, Inc</b>	
Outlook	Stable
Bank Deposits	Baa3/P-3
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
<b>Grupo Aval Limited</b>	
Outlook	Stable
Bkd Senior Unsecured	Ba1
<b>Banco de Bogota S.A.</b>	
Outlook	Stable
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Senior Unsecured	Baa2
Subordinate	Ba1

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## Key Indicators

### Grupo Aval Acciones y Valores S.A.[1]

	Dec-14	Dec-13	Dec-12	Dec-11	Dec-10
Total Assets (COP Billion)	31,369	27,170	22,636	18,897	8,562
Investments in Subsidiaries (COP Billion)	15,529	12,757	10,659	9,695	6,608
Loans to Subsidiaries (COP Billion)	1,804	1,412	1,839	0	0
Total Debt (COP Billion)	4,447	3,807	4,704	2,389	2,496
Shareholders' Equity (COP Billion)	26,430	22,938	17,530	16,178	5,849
Core Earnings (COP Billion) [2]	1,102	972	814	633	481
Interest Expense (COP Billion)	218	276	243	182	92
Double Leverage [3]	117.7%	122.2%	131.9%	110.0%	120.3%
Double Leverage excl. Senior Loans to Subs [4]	109.0%	113.4%	113.1%	110.0%	120.3%
Debt / Core Earnings	4.0 x	3.9 x	5.8 x	3.8 x	5.2 x
Core Earnings / Interest Expense	5.0 x	3.5 x	3.4 x	3.5 x	5.2 x
Liquid Assets / Total Debt [5]	42%	34%	38%	67%	57%
Total Liabilities / Total Assets	15.7%	15.6%	22.6%	14.4%	31.7%

[1] Source: Grupo Aval + Grupo Aval Limited's unconsolidated data in Colombian GAAP and dividend income in Banking GAAP; Moody's estimates. [2] Includes cash flow from dividends, investments and net operating cash outflows. [3] Investments in subsidiaries, goodwill and loans to subsidiaries as percentage of shareholders' equity excluding asset revaluations. [4] Investments in subsidiaries, goodwill and subordinated loans to subsidiaries as percentage of shareholders' equity excluding asset revaluations. [5] Liquid assets includes cash and cash equivalents and fixed income securities held to maturity.

## Opinion

### SUMMARY RATING RATIONALE

On 10 June 2015, Moody's downgraded Grupo Aval Acciones y Valores S.A.'s (Grupo Aval) long- and short-term global local and foreign currency issuer ratings to Ba1/Not Prime, from Baa3/Prime-3. The rating agency also downgraded to Ba1, from Baa3, Grupo Aval's foreign currency senior debt notes issued through its subsidiary in the Cayman Islands, Grupo Aval Limited. The senior debt ratings are based on Grupo Aval's irrevocable and unconditional guarantee of Grupo Aval Limited's liabilities under the indentures.

Grupo Aval's ratings reflect the incorporation of structural subordination of the bank holding company's liabilities versus the liabilities of its highly regulated operating entities, mainly composed of Banco de Bogotá S.A. (Baa2/Baa2 stable, baa3) whose baseline credit assessment was lowered to baa3, from baa2. The one-notch differential takes into account that not all resources flowing up from the operating entities into Grupo Aval could be available, in case of stress.

The differential is limited to only one notch because it incorporates Grupo Aval's strong track record of intrinsic financial performance based on 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, of which Banco de Bogotá is nevertheless the main contributor of dividend income, with about half of total.

Following the COP2.4 trillion capitalization carried out between December 2013 and January 2014 and the COP2.6 trillion capitalization in September 2014, Grupo Aval's double leverage, which is a measure of how much the bank holding company relies on debt to fund the equity in its subsidiaries, improved to a more adequate level of 118% as of year-end 2014, from 132% as of year-end 2012.

Moody's calculation of double leverage includes investments in subsidiaries at book value, loans to subsidiaries and goodwill as a percentage of shareholders' equity, excluding asset revaluations. If senior loans to subsidiaries are excluded from the calculation of double leverage, Grupo Aval's ratio is 109%, as of year-end 2014.

Liquid assets in the form of cash and cash equivalents covered 42% of total debt through year-end 2014, up from a low of 34% as of year-end 2013.

The outlook on Grupo Aval's ratings is stable.

### Rating Drivers

- Structural subordination of the bank holding company's liabilities versus those of its highly regulated operating entities
- Double leverage ratios and liquidity are adequate following capitalizations
- Financial strength hinges on Grupo Aval's ample and stable dividend income
- Family ownership and high dependence on its founder and chairman

### Rating Outlook

All of Grupo Aval's and Grupo Aval Limited's ratings have a stable outlook.

### What Could Change the Rating - Up

An improvement in the intrinsic financial strength of Grupo Aval's subsidiaries would place upward ratings pressure on the group's issuer and debt ratings, especially in terms of an increase in the core capitalization of

Grupo Aval's operating entities. Moody's measures operating bank capitalization as tangible common equity (i.e., common stock minus attributable goodwill, excluding unrelated minority interest) as a percent of total risk weighted assets. Moody's risk weights Colombian government securities at 50%, in line with their Baa2 rating.

### **What Could Change the Rating - Down**

Debt issuances and further acquisitions by Grupo Aval or its subsidiaries, which would materially deteriorate double leverage ratios, would also trigger a reassessment of both the (i) the intrinsic strength of the group's operating entities and (ii) the notching differential between the baseline credit assessment of Banco de Bogotá and Grupo Aval's issuer and debt ratings.

### **DETAILED RATING CONSIDERATIONS**

#### **STRUCTURAL SUBORDINATION**

Grupo Aval's Ba1 issuer ratings reflect the incorporation of the structural subordination of the liabilities of the holding company versus the liabilities of its highly regulated operating entities. The differential takes into account that not all resources flowing up from the operating entities into Grupo Aval may be available, in case of stress.

#### **DOUBLE LEVERAGE RATIOS AND LIQUIDITY ARE ADEQUATE FOLLOWING CAPITALIZATIONS**

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.

Following the COP2.4 trillion capitalization between December 2013 and January 2014 and the COP2.6 trillion capitalization in September 2014 and subsequent capitalization of Banco de Bogotá with COP1.5 trillion, Grupo Aval's double leverage improved to a more adequate level of 118% as of year-end 2014, from 132% as of year-end 2012.

Moody's calculation of double leverage includes investments in subsidiaries at book value, loans to subsidiaries and goodwill as a percentage of shareholders' equity excluding asset revaluations. Nevertheless, if senior loans to subsidiaries are excluded from the calculation of double leverage, Grupo Aval's ratio is 109%, as of year-end 2014.

Liquid assets in the form of cash and cash equivalents covered 42% of total debt through year-end 2014, up from a low of 34% as of year-end 2013.

#### **FINANCIAL STRENGTH HINGES ON GRUPO AVAL'S AMPLE AND STABLE DIVIDEND INCOME**

Grupo Aval maintains a strong track record of intrinsic financial performance based on 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.

Grupo Aval owns the second largest bank in Colombia in terms of loans, Banco de Bogotá, as well as the fifth largest Banco de Occidente S.A. (unrated), the eighth largest Banco Popular S.A. (unrated) and the eleventh largest Banco Comercial AV Villas S.A. (unrated). Grupo Aval also incorporates geographic and industry diversification through Banco de Bogotá's BAC International Bank, Inc. (BAC, Baa3/- stable, baa3), a universal bank present throughout Central America and Corporación Financiera Colombiana S.A. (Corficolombiana, unrated), Colombia's largest merchant bank, as well as from the group's ownership of the country's largest asset manager AFP Porvenir S.A. (unrated). Grupo Aval's banks comprise the largest franchise in Colombia, with a combined market share of 27.8% of the banking system's loans and 28.8% of deposits, as of March 2015.

Dividends effectively received during 2014 increased 15.8% to COP1 trillion, sourced mainly from Banco de Bogotá, which traditionally contributes with a little over half of dividends.

Good earnings generation has led to improvements in Grupo Aval's debt service capacity: a decrease in debt to core earnings (cash flow of: dividends + investments - operating expenses) to 4.0x as of year-end 2014, from 5.8x as of year-end 2012 and core earnings to interest expense improving to 5.0x.

The acquisitions made by Grupo Aval, though with high levels of goodwill, have strengthened the franchise of its existing operating entities. Banco de Bogotá's acquisitions of Guatemala's Grupo Financiero Reformador (unrated) and Banco BAC de Panamá (unrated), both completed in December 2013, strengthened the market presence of BAC in two key growth markets in the region. The acquisition of BBVA Horizonte AFP S.A. in Colombia added

notable market share to Porvenir and assured Porvenir's dominance in the administration of mandatory pension funds and severance funds in Colombia and its position as the third-largest provider of voluntary pensions.

#### FAMILY OWNERSHIP AND HIGH DEPENDENCE ON ITS FOUNDER AND CHAIRMAN

Moody's acknowledges the depth 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.

Nevertheless, an area of weakness for Grupo Aval is its family ownership and high dependence on its founder and chairman, Dr. Sarmiento Angulo and president, Mr. Sarmiento Gutiérrez. The Sarmiento family has the ability to elect a majority of directors, executive officers, set management policies and to determine the outcome of most or all actions requiring shareholder approval at both the holding and operating bank levels.

While Grupo Aval is not supervised through banking regulators, it is registered and regulated under Colombia's National Registry of Shares and Issuances and the US Securities and Exchange Commission, and is required to comply with corporate governance and periodic reporting requirements. Grupo Aval is traded in the NYSE Euronext under ticker AVAL.

#### Foreign Currency Debt Rating

Moody's rates two long-term foreign currency debt notes issued through Grupo Aval's subsidiary in the Cayman Islands, Grupo Aval Limited at Ba1. The Ba1 long-term foreign currency debt rating is based on Grupo Aval's irrevocable and unconditional guarantee of Grupo Aval Limited's liabilities under the indenture:

- a) Five-year senior unsecured notes of USD600 million (coupon of 5.25%) due 25 January 2017; first rated on 17 January 2012.
- b) Ten-year senior unsecured notes of up to USD1 billion (coupon of 4.75%); first rated on 18 September 2012.

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