MOODY'S
INVESTORS SERVICE

Credit Opinion: BAC International Bank, Inc

Global Credit Research - 22 Jul 2014

Panama City, Panama

Ratings

Category	**Moody's Rating**
Outlook	Stable
Bank Deposits	Baa3/P-3
Bank Financial Strength	D+
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Ult Parent: Grupo Aval Acciones y Valores S.A.	
Outlook	Negative
Issuer Rating	Baa3
ST Issuer Rating	P-3
Parent: Banco de Bogota S.A.	
Outlook	Negative(m)
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

Contacts

Analyst	**Phone**
Jeanne Del Casino/New York City	1.212.553.1653
Felipe Carvallo/Mexico	52.55.1253.5700
M. Celina Vansetti/New York City	1.212.553.1653
Lauren Kleiman/Mexico	52.55.1253.5700

Key Indicators

BAC International Bank, Inc (Consolidated Financials)[1]

	[2]**3-14**	[2]**12-13**	[2]**12-12**	[2]**12-11**	[2]**12-10**	**Avg.**
Total Assets (USD million)	**14,476.7**	**14,208.8**	**10,681.9**	**9,198.9**	**8,408.7**	[3]**14.5**
Tangible Common Equity (USD million)	**1,275.1**	**1,075.0**	**1,126.2**	**974.4**	**843.8**	[3]**10.9**
Net Interest Margin (%)	**6.0**	**6.6**	**6.9**	**7.2**	**7.1**	[4]**6.7**
PPI / Average RWA (%)	**6.1**	**5.4**	**5.5**	**5.4**	**4.7**	[5]**5.4**
Net Income / Average RWA (%)	**3.6**	**3.1**	**3.2**	**3.0**	**2.3**	[5]**3.1**
(Market Funds - Liquid Assets) / Total Assets (%)	**-10.4**	**-8.3**	**-12.5**	**-13.2**	**-17.9**	[4]**-12.5**
Core Deposits / Average Gross Loans (%)	**104.7**	**120.6**	**112.0**	**112.2**	**117.6**	[4]**113.4**
Tier 1 Ratio (%)	**10.4**	**10.9**	**13.5**	**13.7**	**13.5**	[5]**12.4**
Tangible Common Equity / RWA (%)	**11.8**	**10.0**	**12.5**	**12.8**	**12.4**	[5]**11.9**
Cost / Income Ratio (%)	**54.7**	**57.1**	**57.8**	**59.7**	**64.2**	[4]**58.7**
Problem Loans / Gross Loans (%)	**1.3**	**1.1**	**1.3**	**1.6**	**2.3**	[4]**1.5**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**7.3**	**6.7**	**7.1**	**8.3**	**12.1**	[4]**8.3**

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel I; US GAAP [3] Compound Annual Growth Rate based on US GAAP reporting periods [4] US GAAP reporting periods have been used for average calculation [5] Basel I & US GAAP reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a D+ standalone bank financial strength rating (BFSR) and a baa3 baseline credit assessment to BAC International Bank, Inc. (BAC), a wholly-owned subsidiary of Banco de Bogotá (C-/baa2/Baa1/Baa3, negative). We also assign BAC long and short term local and foreign currency deposit ratings of Baa3 and Prime-3, respectively, in line with the standalone ratings. We do not assume systemic support for BAC's deposit ratings because it is a US dollar-based bank with no lender of last resort. The standalone ratings reflect BAC's franchise as a leading bank and credit card issuer in Central America well positioned to take advantage of the region's growth opportunities. The bank's recent acquisitions of Guatemala's Grupo Reformador (Reformador) and the former Banco Bilbao Vizcaya Argentaria (Panamá), S.A. (BBVA Panamá, unrated) have boosted the bank's regional presence to the number one spot, while adding heft to its market positions in two attractive growth markets. The ratings also reflect the bank's strong profitability and earnings diversification and conservative approach to asset quality, liquidity, and capital management. BAC funds its operations mainly through customer deposits that are sourced from its regional network of branches, ATMs, and electronic distribution channels. Its stable funding profile is supported by flows derived from its extensive account and point-of-sale relationships with merchants through its credit card acquisition business.

A key risk to BAC's performance is its acquisitive, high growth strategy and the potential for asset quality deterioration as the bank continues to grow its consumer finance and commercial banking business in developing Central American markets. Heavy competition from regional and international players and a growing cost base also pose challenges to the bank's profitability. However, pre-provision profit margins have remained firm on a risk-weighted basis and scale efficiencies have been improving. The lack of a lender of last resort is an important risk to BAC's liquidity that is partly mitigated by its stable core funding base and substantial holdings of liquid assets, the latter maintained at more conservative levels generally than those required by regulators. A largely short term and granular loan portfolio also serves as a source of alternate liquidity. BAC's complex corporate structure of intermediate holdings and operating companies in numerous jurisdictions presents transparency and control challenges, however, its centralized business and risk management structure and integrated systems for control, compliance, and audit help mitigate those risks.

Moody's affirmed the ratings of BAC with a stable outlook in July 2013 following the announcement that Banco de Bogotá would acquire 98.92% of BBVA Panamá via its Panamanian subsidiary, Leasing Bogotá S.A. Panamá (Leasing Bogotá), and eventually merge its operations with those of BAC Panamá. Grupo Aval, Banco de Bogotá's 66.5% parent holding and BAC's ultimate parent, together with minority shareholders, capitalized Banco de Bogotá with approximately US$ 675 million to support this acquisition as well as that of Reformador, both completed in December 2013. In the event Banco de Bogotá carries out its plans to merge BBVA Panamá into BAC Panamá, we expect the related goodwill to be offset by an indirect transfer of capital from Leasing Bogotá at the time of the merger, which is now expected to occur in the second half of 2014.

Rating Drivers

- Margins under pressure due to increasing competition and higher funding costs

- Growing credit exposures in developing markets, though diversifying and well managed to date

- Strong customer funding, liquidity and capital help compensate for absence of lender of last resort

- Leading bank and credit card issuer/merchant acquirer in Central America with established regional footprint

Rating Outlook

The outlook for all ratings is stable.

What Could Change the Rating - Up

Upward movement of the bank's standalone and deposit ratings is currently limited by the bank's high growth and acquisitive strategy, as well as its geographic footprint. Following the absorption of BBVA Panama together with the relevant capital offset, an upgrade could occur with sustained expansion of core profitability and maintenance of good asset quality, liquidity, and capitalization.

What Could Change the Rating - Down

Ratings could come under downward pressure if financial fundamentals, particularly asset quality, capital or liquidity, deteriorated significantly. Failure to provide capital to support BAC's absorption of BBVA Panamá, or further acquisitions that negatively affect the bank's tangible capital ratios could also prompt a negative rating action.

DETAILED RATING CONSIDERATIONS

Detailed considerations on BAC's ratings are as follows:

Margins under pressure due to increasing competition and higher funding costs

BAC's strong profitability benefits from a diversified mix of revenues from both retail and commercial banking, low cost customer-based funding, and good control of credit and operating costs. Its primary lending focus on credit cards and other consumer credit is reflected in the bank's ample margins and fee income, the latter contributing around 30% of total operating revenues. Lending margins particularly in the commercial sphere remain vulnerable however as competition in the region continues to heat up and USD interest rates eventually rise. The heavier proportion of lower margin commercial lending and residential mortgages in the business mix, together with higher funding costs, has led to a decline in margins relative to the bank's historical levels.

2013 earnings nevertheless continued to expand, by 12.3% to US$ 297.6 million, on the back of 16% organic loan growth (30% overall growth reflects addition of Banco Reformador at year end 2013). The net interest margin declined to 6.6% from 6.9% in the prior year, growth of interest revenues was outpaced by interest expense, particularly because of increased long term debt. The pre-provision income to risk-weighted asset ratio remained relatively stable at 5.5%, reflecting higher non-interest income (mainly fees and commissions and increased trading gains) and good control of operating costs. Returns on average assets and equity both declined slightly, to 2.5% from 2.7%, and to 22.5% from 23.7%, respectively, as provisions took a larger bite out of PPI. First quarter 2014 earnings jumped by 41.5% year over year to $97.7 million, mainly due non-recurring items, reflecting a surge in foreign exchange income only partly offset by extraordinary operating expenses related to the Reformador acquisition. Returns on average assets and equity rose to 2.72% and 26.5%, respectively. The net interest margin suffered a 71 basis point decline to 6.02% from 6.7% in the prior year quarter again mainly due to higher interest expense. We expect margins to remain within that range given interest rate trends in the region as well as competition in all of BAC's main businesses.

Growing credit exposures in developing markets, though diversifying and well managed to date

A key risk for BAC is its high loan growth as it may lead to rapid asset quality deterioration particularly as the bank extends its presence in the developing markets of Central America. Nevertheless, the bank presents good product and geographic diversification and asset quality metrics, indicative of management's deep knowledge of its markets and proactive management of problem loans. BAC's problem loan ratios have declined in recent years, reflecting stricter underwriting policies and asset management. Problem loans remained contained at 1.3% as of March 2014 and 8.5% of reserves and capital.

BAC continues to diversify its country, customer, and product concentrations which results in an increasingly balanced credit portfolio. Its loan portfolio is skewed towards high quality growth markets such as Panama, comprising 27%, Costa Rica, with 25%, and Guatemala, with 19%. The loan book in Honduras contributes 11%, El Salvador 10%, and Nicaragua 8%. The bank has gradually reduced its concentration in credit cards, which now represent 21% of total loans, while commercial lending and residential mortgages comprise 40% and 24%, respectively, and other consumer loans (installment and auto), comprise 15%. This asset mix helps keep delinquencies and charge-offs in check. The bank also maintains a relatively balanced mix of product lines in each country. Commercial loans are diversified by economic sector, with the largest concentrations within the broad areas of commerce (34%), services (17%), and industry (13%). Exposures to SMEs are very modest, equalling about 5% of total loans.

Credit risk is managed centrally, with narrow latitude granted to local offices. The bank's Chief Risk Officer (CRO) reports directly to the CEO on credit, market, and operational risks, and each country has a local CRO. BAC has enhanced its operational risk management through continuous improvements in identifying process risks and periodic monitoring of exposures. The bank possesses the ISO 9000 certification for all bank and credit card processes since 2000.

Strong customer funding, liquidity and capital help compensate for absence of lender of last resort

BAC's balance sheet liquidity is supported by a diverse and stable funding base and prudent liquidity and capital management. The bank derives the majority of its funding (77%) from its customers, split about evenly between companies (including merchant relationships) and individuals. Institutional sources contribute the remainder. Deposits grew by 32% year over year as of March 2014, partly as a result of the Reformador acquisition. BAC also increased its use of borrowings by 50%, to reach 19% of total funding from 15.8%, to support its expansion and the acquisition of Grupo Reformador. The $421 million purchase price of the acquisition was financed in part through a seven-year securitization of American Express merchant voucher receivables in the amount of $282 million, at a rate of 4.5%, which more than doubled the bank's funding from that source to $490 million during 2013. The bank also received an eight year subordinated loan in the amount of $180 million from Grupo Aval, at a rate of 7.7%, to complete the acquisition financing and support growth.

BAC's liquid asset holdings, relatively short term loan book and strong tangible capitalization supports the bank's standalone liquidity. Its 30% liquid asset ratio is in line with banks domiciled in fully and highly dollarized countries such as Panama, El Salvador, and Costa Rica. Slightly higher than its historical norm of closer to 25%, we would expect this level to come down a bit as loan growth picks up. BAC's liquid assets are of high quality, composed chiefly of cash and due from banks and securities of highly rated international banks and investment grade Central American governments. 55% of the bank's loan book is short term and relatively granular providing the bank with an alternate source of liquidity. Management is proactive in managing interest rate, maturity, and currency gaps and does regular sensitivity analysis taking into consideration funding stresses experienced by the bank under various historic stress scenarios.

The bank's Tier 1 capital ratio declined by 265 basis points during 2013 to 11.22%, reflecting both organic growth and the acquisition of Grupo Reformador, while the total capital ratio declined by 86 basis points to 12%, bolstered by the new Tier 2 subordinated loan. We expect BAC's capital levels to continue to be supported by higher earnings retention as well as a capital transfer from its parent upon the accounting merger between BAC Panama and BBVA Panama to support the acquisition-related goodwill.

Leading bank and credit card issuer/merchant acquirer in Central America with established regional footprint

BAC is a major regional bank, credit card issuer and merchant acquirer in Central America and a leader in electronic banking and alternative distribution channels. BAC is present in all Central American countries, except Belize, an area that represents US$198 billion of GDP and 45 million inhabitants. We expect per capita income growth to continue for the Central American region in the coming years, with projected GDP growth of 4% in 2014, led by Panama, Costa Rica and Guatemala, as well as improving employment conditions and remittance flows. Country risk profiles have also improved in the markets where the bank is most active offering a solid backdrop for BAC's expansion strategy. Following its 2013 acquisitions, the bank holds loan market shares of 10.3% and 7.5%, respectively, in Guatemala and Panama, up from 4.9% and 3.5%, and maintains critical market shares in its traditional markets of Costa Rica (11.8%), El Salvador (11%), Honduras (12.8%), and Nicaragua (27.2%). Costa Rica (35%) and Guatemala (20%) contributed the lion's share to net income as of December 2013, based on both loan mix and higher margins, followed by Honduras and Nicaragua, each contributing 13%, El Salvador with 10%, and Panama with 9%.

BAC competes effectively against both international banks (e.g., Citibank and Scotiabank, among others) and regional institutions (e.g., Bancolombia, Banco General, Banco Industrial, and Banco de Costa Rica) through an integrated multi-country online banking platform. BAC has established premier alliances with all major credit card networks and has an exclusive arrangement with American Express. The bank also has the only network in the region that processes all major credit card brands, including Visa, Master Card, and Diners Club and has co-branding relationships with major airlines and retailers. BAC owns its merchant point-of-sale (POS) network which enhances its functionality, independence, and efficiency. 98% of all credit card authorizations are processed electronically and 88% of its processing volume is credited to merchant bank accounts with BAC. Through this payment chain, the bank processed $24 billion in 2013 in payment flows from merchant deposits and internal supplier payments. These flows also generated about $11 billion in payroll and Ameritransfer payments, all of which earn processing fees for the bank. In addition, 93% of its merchant clients keep accounts with BAC, with balances of $943 million as of December 2013, providing the bank with an additional core funding source.

Although challenges of high poverty, political instability, and criminal activity remain in certain countries, management's experience doing business in the region is key to the success of its operations. BAC's affiliation with Banco de Bogota also affords it access to additional management and financial resources to support its regional diversification strategy and provides a growth opportunity for both banks by offering banking services to Colombian companies doing business in Central America.

Business Profile

Incorporated as BAC International Bank, Inc. in 1995 in Panama, BAC is the largest local banking group in Central America, with loan and deposit market shares of 9.2% and 8.3%, respectively, including the recent acquisitions of Reformador and BBVA Panama. It is also the largest credit card issuer and merchant acquirer in the region with market shares of 35% and 54%, respectively. As of March 2014, the bank reported total receivables of $9.2 billion, deposits of $9.6 billion, and shareholders' equity of approximately $1.5 billion. BAC's network post acquisitions is now comprised of 626 branches and 1,541 ATMs (the largest in the region, with a 15.2% market share), and 20,477 employees. BAC serves three million clients with three million credit and debit cards issued. BAC also processed some $21 billion in international transfers in 2013. BAC is both the holding for the group's banking and credit card businesses in the region as well as being a regulated operating bank. BAC is regulated by the Panamanian Superintendency of Banks and in all of its markets, as well as being subject to Colombian banking regulations as a subsidiary of Banco de Bogotá.

BAC's 100% holding, BAC Credomatic, Inc., is controlled by Colombia's Grupo Aval, in turn the 67.6% owner of Banco de Bogotá. BAC's earnings represent about a third of Banco de Bogotá's consolidated net income. Founded in Nicaragua under the name of Banco de América in 1972 under the brand Credomatic, BAC pioneered the card business as a regional strategy in Central America. As democracy and financial stability returned to the region in the 1990s, the bank gradually developed a regional business by establishing banks and credit card companies in each of Costa Rica (where senior management resides), Panama, Honduras, Guatemala, El Salvador, Nicaragua, and Mexico. BAC was acquired by Banco de Bogota in 2010.

Final Rating versus Scorecard Result

BAC's assigned D+ BFSR is two notches lower than the C outcome of Moody's bank financial strength scorecard. The scorecard does not fully capture the competitive, growth-related, or cross border challenges faced by BAC.

Global Local Currency Deposit Rating (Joint Default Analysis)

BAC's global local and foreign currency deposit ratings of Baa3 are based on a stand-alone baseline credit assessment of baa3 that is mapped from the D+ standalone BFSR. We do not incorporate systemic support in BAC's deposit ratings given the lack of true lenders of last resort in the bank's markets, most of which are either fully or highly dollarized. We assess a moderate probability of parental support because of the bank's dollarization and cross border domicile. This assessment does not result in further ratings uplift for BAC at current ratings levels.

Notching Considerations

Senior debt would be rated similarly to deposits. Junior obligations are subject to Moody's standard notching practices.

Foreign Currency Deposit Rating

BAC's Baa3 foreign currency deposit ratings are not constrained by the country ceiling for Panama.

Rating Factors

BAC International Bank, Inc

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (70%)						**D+**	
Factor: Franchise Value						**C-**	**Improving**
Market share and sustainability			**x**				
Geographical diversification				**x**			

Earnings stability			x				
Earnings Diversification [2]							
Factor: Risk Positioning						**C**	**Neutral**
Corporate Governance [2]				x			
- Ownership and Organizational Complexity				x			
- 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+**	**Improving**
Economic Stability				x			
Integrity and Corruption				x			
Legal System			x				
Financial Factors (30%)						**B+**	
Factor: Profitability						**A**	**Improving**
PPI % Average RWA (Basel I)	5.20%						
Net Income % Average RWA (Basel I)	2.86%						
Factor: Liquidity						**B**	**Neutral**
(Market Funds - Liquid Assets) % Total Assets	-14.54%						
Liquidity Management			x				
Factor: Capital Adequacy						**A**	**Neutral**
Tier 1 Ratio (%) (Basel I)	13.55%						
Tangible Common Equity % RWA (Basel I)	12.53%						
Factor: Efficiency						**C**	**Improving**
Cost / Income Ratio			60.56%				
Factor: Asset Quality						**B+**	**Neutral**
Problem Loans % Gross Loans		1.73%					
Problem Loans % (Equity + LLR)	9.16%						
Lowest Combined Financial Factor Score (9%)						**B**	
Economic Insolvency Override						**Neutral**	
Aggregate BFSR Score						**C**	
Aggregate BCA Score						**a3**	
Assigned BFSR						**D+**	
Assigned BCA						**baa3**	

[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.