Research Update:
Bancolombia, S. A. y Companias Subordinadas 'BBB-/A-3' Ratings Affirmed; Outlook Remains Stable

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Overview
- A steady loan portfolio growth at Colombia-based universal bank, Bancolombia, has maintained its prominent and leading market position in the Colombian banking system.
- Still, aggressive acquisitive strategy has pressured its risk-adjusted capital level, which remains its main rating weakness.
- We are affirming our 'BBB-' long-term and 'A-3' short-term ratings on the bank.
- We expect Bancolombia to keep its strong market share and a barely moderate 5% risk-adjusted capital level for the next 12-18 months.

Rating Action
On Sept. 9, 2013, Standard & Poor's Ratings Services affirmed its 'BBB-' long-term and 'A-3' short-term issuer credit ratings (ICRs) on Bancolombia S.A. y Companias Subordinadas (Bancolombia). The outlook is stable.

Rationale
The ICRs on Bancolombia continue to reflect our "strong" assessment for its business position, our "moderate" view of its capital and earnings--its major rating weakness--and our opinion of its "adequate" risk position. The ratings also consider our assessment of its "average" funding with "adequate" liquidity (as our criteria define these terms). The stand-alone credit profile (SACP) remains at 'bbb-'.

The 'bbb-' anchor draws on our Banking Industry Country Risk Assessment (BICRA) methodology and our view of the weighted average economic risk in the countries in which Bancolombia, on a consolidated basis, has exposure through its loan book--Colombia (80%), Panama (15%), and El Salvador (5%). This exposure takes into consideration our anticipation of inorganic growth in Panama, through the expected acquisition of HSBC Bank (Panama) S.A. As a result, the weighted economic risk is about '6'. Our bank criteria use the BICRA economic and industry risk scores to determine a bank's anchor, the starting point in assigning an ICR. Our economic risk score of '6' on its largest exposure, Colombia, reflects its economic concentration in cyclical commodity sectors, limited fiscal flexibility based on the population's low income levels when compared globally, high unemployment, and inefficient rule
of law, which hinders the claims process for loan collateral. On the positive side, however, we currently don't see any asset bubbles in the Colombian economy. Our industry risk score of '5' is based on Colombia's improvements to underwriting standards, transparency, and good disclosure of accounts and ownership of banks, which have created favorable conditions and strengthened supervision and coverage. The central bank's lending facilities and policies are adequate in terms of capacity, and it has a good track record of providing guarantees, transparency, and liquidity. The country's banks also enjoy a stable and expanding base of core customer deposits. However, in our view, the country's still-shallow capital markets, lack of long-term funding alternatives that harms asset-liability management, and moderate use of securitization continue to constrain the industry.

A leading market position in the Colombian financial system, coupled with sound franchise value and brand recognition, underscore our view of the bank's "strong" business position. Bancolombia holds an almost unchallenged market position, with a market share of 24.7% in terms of total loans and 21.1% in terms of total deposits, as of June 2013. Bancolombia is practically the leading bank in all the business lines in which it participates. Its nationwide footprint and an ample branching network also supports the bank's business stability. In addition, the bank has recently announced its intention to acquire Panama-based HSBC Bank (Panama) S.A. (HSBC Panama; BBB-/Watch Neg/A-3) and a 40% minority stake in Guatemala-based Grupo Financiero Agromercantil (GFA; not rated). If these transactions are carried out as expected, Bancolombia will become the largest financial group in Central America, which will further enhance its geographic presence and business diversification in Latin America. Based on our expectations of the bank's planned business growth and geographic expansion, its business position will likely remain strong.

Our opinion of Bancolombia's capital and earnings remains "moderate." Past and expected growth through acquisitions results in a forecasted risk-adjusted capital (RAC) ratio of barely 5% for the next 18 months. Our forecasted RAC remains pressured due to expected goodwill stemming from the recent announcement of HSBC Panama's acquisition. The RAC ratio could fall below 5% over the next 18 months due to leveraged acquisitions, higher-than-expected organic growth, lower internal capital generation stemming from asset quality deterioration and higher provisions, or increased operating expenses. In that case, we will reassess our view of Bancolombia's capital and earnings and revise downward our SACP assessment on the bank. However, the final ICRs will remain at the current level because they will incorporate one notch of government support. We also don't expect fresh capital injections in the form of common equity for the next 18 months.

Bancolombia's capital is a combination of paid-in capital, retained earnings, capital reserves, and preferred shares. We continue to grant intermediate equity content to its preferred shares. Earnings were recently pressured due to increased provisions and some negative valuations in the bank's investment portfolio as a result of higher interest rates. Nonetheless, we continue to view Bancolombia's earnings capacity and profitability metrics as adequate. As
of June 2013, Bancolombia's core earnings to average adjusted assets was 1.4%, and we currently forecast this ratio to remain the same for the next 18 months due to its newly acquired businesses.

Our opinion about Bancolombia's risk position reflects adequate risk concentrations and adequate credit losses. The bank shows satisfactory risk dispersion among some asset classes. As of June 2013, its loan portfolio was comprised of commercial/corporate loans (58.2%), consumer loans (17.8%), leases (14.6%), residential real estate mortgages (8.5%), and other loans and acceptances (0.9%). In addition, its top 20 exposures represented only 8.9% of its total loan portfolio and 60.4% its total reported equity. Nonperforming assets (NPAs; with nonperforming loans of more than 30 days, as per Colombian regulation) and credit losses have been historically very in line with the system's average, and we deem those as adequate. As of June 2013, NPAs were 2.5% with a three-year average of 3%. Credit losses--measured as net charge offs--were 0.9%, with a three-year average of 1%. We noted some deterioration in NPAs and credit losses during 2012 as a result of the growth in consumer loans, but recent loan vintages have shown better credit risk performance. We currently forecast NPA and credit losses to be about 2.5% and 1.0%, respectively, levels that we consider as manageable.

Our view of Bancolombia's funding remains "average" and liquidity "adequate", when we compared our main funding and liquidity ratios with local peers and other payers within the same industry risk score. As of June 2013, customer deposits represented 75.4% of the bank's total funding base. The remainder are interbank lines, other credit facilities, and senior unsecured bonds. Our stable funding ratio stood at 111.6% at second-quarter 2013, with a three-year average of 107.1%. These levels are very similar to our estimate for the Colombian banking system, which shows a three-year average stable funding ratio of 108.2%. We believe these levels are adequate because of Bancolombia's asset profile, which is more related to customer loans, and its ample deposit base. We expect this funding structure to remain, because we believe that customer deposits will continue to rise at a solid rate. We also based this expectation on the bank's ample branching network in which it leverages its deposit growth. Actually, the share of deposits has remained fairly stable for the past several years.

Our view of Bancolombia's "adequate" liquidity reflects its manageable refinancing risk and adequate liquidity coverage. As of June 2013, the bank's broad liquid assets covered its short-term wholesale funding by 3.0x. The three-year average liquidity ratio was 2.7x. The bank boosted its liquidity through the bond issuance in 2012 in preparation for HSBC Panama's acquisition and its 40% minority stake in GFA. These transactions, if carried out as expected, will total $2.3 billion. Adjusting our liquidity ratio by this cash outflow, the June 2013 ratio would stand at 2.4x, more in line with the bank's 1.9x ratio for the previous years. Liquidity in Colombia is particularly high because of strict and tight regulatory oversight. Likewise, refinancing risk is manageable with a satisfactory maturity profile. The majority of Bancolombia's debt issuances mature in 2016 and thereafter. We expect adequate liquidity management to remain.
We continue to view Bancolombia as a highly systemic financial institution. This view stems from its leading market share in terms of deposits, of 21.1% at June 2013, and its importance in the country's payment system. In addition, its 12% market penetration in the consumer segment makes it a very important player in the local market. Also, we view the Colombian government as being "supportive" towards its financial system. In this regard, we believe there is a "moderately high" likelihood of extraordinary government support to Bancolombia.

Currently, its SACP of 'bbb-' does not incorporate any notches of support, given Colombia's current local currency rating (BBB+/Stable/A-2), which along with the bank's SACP, leaves the rating at the 'BBB-' level.

**Outlook**

The stable outlook reflects our expectation that Bancolombia will remain as the largest financial institution with a highly systemic status in Colombia, keeping its predominant market position and business stability. The outlook also reflects our view that the bank will keep a barely 5% RAC ratio for the next 12-18 months, and that no further acquisitions for the next two years occur. An upgrade could occur if we raise our local currency rating on Colombia, because we see as less likely that the bank could improve its SACP in the next 12-18 months.

**Ratings Score Snapshot**

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<tr>
<th>Issuer Credit Rating</th>
<th>BBB-/Stable/A-3</th>
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<tbody>
<tr>
<td>SACP</td>
<td>bbb-</td>
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<tr>
<td>Anchor</td>
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<td>Business Position</td>
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<tr>
<td>Capital and Earnings</td>
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<tr>
<td>Risk Position</td>
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<td>Funding and Liquidity</td>
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<td>Support</td>
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<td>Government Support</td>
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</tr>
<tr>
<td>Additional Factors</td>
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</tbody>
</table>
Related Criteria And Research

- Credit Conditions: Subdued Growth Is Increasing Downside Risks For Latin America, Aug. 9, 2013
- Assigning "Intermediate" Equity Content To "Tier 2" Bank Hybrid Capital Instruments, July 16, 2013
- Latin American Banks' Financial Performance Remained Adequate Amid Favorable Regional Economy, June 11, 2013
- General Criteria: Group Rating Methodology, May 7, 2013
- S&P Risk-Adjusted Capital Ratios Provide A Consistent Assessment Of Latin American Banks' Credit Quality, April 29, 2013
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Ratings List

Ratings Affirmed

Bancolombia, S. A. y Companias Subordinadas
Bancolombia Panama S.A.
  Counterparty Credit Rating        BBB-/Stable/A-3

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.
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