Moody’s
INVESTORS SERVICE
Rating Action: Moody’s affirms Bancolombia’s ratings with negative outlook following preferred share issuance

Global Credit Research - 01 Apr 2014

Mexico, April 01, 2014 -- Moody’s Investors Service has today affirmed all ratings on Bancolombia S.A. with a negative outlook, including its bank financial strength rating (BFSR) of D+, which maps to a standalone baseline credit assessment (BCA) of baa3, and its global local currency long- and short-term deposit ratings of Baa2/Prime-3. Moody’s also affirmed Bancolombia’s foreign currency long- and short-term deposit ratings of Baa3/Prime-3; foreign currency senior debt rating of Baa2; and foreign currency subordinated debt rating of Ba1.

RATINGs RATIONALE
AFFIRMATION OF RATINGS

In affirming Bancolombia's ratings, Moody’s acknowledged the benefits of the bank's partial capital replenishment resulting from its February 2014 preferred share issuance in the amount of COP2.7 trillion (approximately USD1.3 billion), which added 240 basis points to the adjusted Tier 1 capital ratio. Based on Moody’s estimates, Bancolombia's adjusted Tier 1 capital ratio increased to 7.36% following the share issuance, from a low 4.96% as of year-end 2013.

Capital ratios came under pressure in the second half of 2013 as a result of Bancolombia's sequential acquisitions of a 40% minority stake in Guatemala’s Grupo Agromercańti Holding S.A. (GFAM) on 1 October 2013 for USD216 million, and of 98.12% of Panama’s Banistmo, S.A. (former HSBC Bank (Panamá), S.A.) on 28 October for USD2.1 billion. Earlier, in August 2013, the Colombian regulator had adopted new capitalization rules that called for the deduction of intangibles, including goodwill generated after August 2012. The acquisition of Banistmo generated an estimated goodwill of USD1.5 billion. Combined, these events reduced the bank’s capitalization ratio by an estimated 560 basis points during the second half of 2013. Moody’s adjusts Colombian banks' core capital ratios by also deducting the grandfathered goodwill, and by risk-weighing the bank's exposure to government securities according to their credit rating, in line with Basel standards.

Bancolombia's ratings also incorporate the bank's conservative credit risk management that ensures a consistently low level of past due loans, supported by high level of reserves. At 4.5% of gross loans, or approximately 300% of past due loans, Bancolombia's loan loss reserves adequately protect its balance sheet and help offset its relatively low capitalization levels. Moreover, Moody’s notes that there appears to be little change to the bank's asset quality as a result of its Banistmo acquisition.

With a sizable market share of 22% of the system's loans and deposits, Bancolombia has a defendable franchise in Colombia, its home market, followed by Banco de Bogotá with 12% and 14%, respectively, as of year-end 2013. In Panama, Banistmo is the second largest bank in terms of domestic loans and deposit-taking, after Banco General S.A., while it holds a leading position in El Salvador, where it operates its wholly owned subsidiary Banco Agricola, S.A.

NEGATIVE OUTLOOK ON RATINGS

Moody’s nevertheless maintains its negative outlook on Bancolombia’s ratings to reflect concerns that earnings generation will continue to be pressured by low net interest margins and securities gains, due to more competitive home market conditions and higher benchmark interest rates that may undo recent improvements in the bank’s funding costs and mix. In addition, we expect operating costs related to the integration of Banistmo and BAM to remain high, with Banistmo remaining non-accretive for the next 12-18 months.

Moreover, despite the recent replenishment, Bancolombia's capitalization ratios remain low by its historical standards, and when compared to its rated bank peers. We note the bank raised considerably less capital through the recent issuance than the USD2.1 billion that Moody’s had anticipated and which had been approved by Bancolombia's shareholders in March 2013. If management's appetite for acquisitions persists, the bank’s capitalization will face further downward pressure, unless it raises additional capital.

The rating will face downward pressure if earnings and capitalization levels continue to weaken, or if the bank
undertakes further unfunded acquisitions. However, the outlook could return to stable if earnings rise to levels consistent with the bank’s ongoing double digit organic and non-organic loan growth, or if the bank’s core capital is strengthened.

Bancolombia’s local currency deposit rating of Baa2 incorporates one notch of uplift from the bank’s baa3 standalone BCA, based on Moody’s assessment that in the event the bank faces stress, systemic support will be forthcoming as a result of the bank’s importance to Colombia’s banking system.

The principal methodology used in these ratings was Moody’s Global Banks Methodology published in May 2013. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

The date of the last Credit Rating Action was 1 November 2013 when Moody's confirmed all of Bancolombia's ratings with a negative outlook.

Bancolombia is headquartered in Medellín, Antioquia, Colombia and had USD67.7 billion in assets, USD46.3 billion in gross loans, USD44.8 billion in deposits, and net income of USD811 million as of year-end 2013.

The following ratings of Bancolombia were affirmed with a negative outlook:

Bank Financial Strength Rating of D+
Long term global local currency bank deposit ratings of Baa2
Short term global local currency bank deposit ratings of Prime-3
Long term foreign currency bank deposit ratings of Baa3
Short term foreign currency bank deposit ratings of Prime-3
Long term foreign currency senior unsecured debt ratings of Baa2
Long term foreign currency subordinated debt ratings of Ba1

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