Bancolombia S.A.

Update to credit analysis

Summary

Bancolombia's baseline credit assessment (BCA) of ba1 reflects its capacity to sustain sound profitability despite the negative pressures on asset risk, mainly arising from the bank's corporate loan book segment. At the same time, it incorporates the bank's relevant exposure to less developed, and in some cases increasingly risky, operating environments in Central America, which also negatively weight its Macro Profile. The BCA also incorporates its low adjusted capitalization which has stabilized as loan growth has declined. Bancolombia has broad access to core funding, which offsets the risks associated market funding obtained and low liquid assets.

The bank's long-term deposit and senior unsecured debt ratings of Baa2 reflect the very high probability that the bank will receive government support in a situation of financial stress, which results in two notches of uplift from its ba1 BCA.

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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Exhibit 1

Rating Scorecard - Key Financial Ratios

Scorecard Ratios as of September 2018

Source: Moody's Financial Metrics
Credit strengths
» Broad stable core funding access

Credit challenges
» Deterioration in corporate loan book put pressure in the bank’s rating
» Credit costs have taken a toll in results
» Capitalization is low and could deteriorate if the bank accelerates growth

Outlook
On 23 February 2018, the long-term deposit and senior unsecured debt ratings assigned to Bancolombia had the outlook changed to negative, from stable, following the change in the outlook of Colombia’s sovereign bond rating announced on 22 February 2018.

Factors that could lead to an upgrade
» Bancolombia’s deposit and senior unsecured debt ratings are unlikely to face upward pressures because they have a negative outlook and are already positioned at the same level as the sovereign rating, which also has a negative outlook. However, the outlook could be stabilized if and when Colombia’s sovereign outlook stabilizes.

Factors that could lead to a downgrade
» Bancolombia’s deposit and senior unsecured debt ratings are positioned at the same level of sovereign bond rating and will likely be downgraded if Colombia’s sovereign rating is lowered.
» The bank’s BCA and ratings could also face downward pressure if Bancolombia’s asset quality continue to deteriorate, or if the Moody’s adjusted capital ratios falls by more than 100 basis points.

Key indicators
Exhibit 2
Bancolombia S.A. (Consolidated Financials) [1]

<table>
<thead>
<tr>
<th></th>
<th>9-18(^2)</th>
<th>12-17(^2)</th>
<th>12-16(^2)</th>
<th>12-15(^2)</th>
<th>12-14(^2)</th>
<th>CAGR/Avg.(^3)</th>
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<tr>
<td>Total Assets (COP billion)</td>
<td>206,655</td>
<td>203,908</td>
<td>196,261</td>
<td>192,973</td>
<td>149,630</td>
<td>9.04</td>
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<tr>
<td>Total Assets (USD million)</td>
<td>69,595</td>
<td>68,321</td>
<td>65,377</td>
<td>60,788</td>
<td>62,963</td>
<td>2.74</td>
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<tr>
<td>Tangible Common Equity (COP billion)</td>
<td>13,970</td>
<td>13,935</td>
<td>12,497</td>
<td>9,974</td>
<td>11,550</td>
<td>5.24</td>
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<tr>
<td>Tangible Common Equity (USD million)</td>
<td>4,705</td>
<td>4,669</td>
<td>4,163</td>
<td>3,142</td>
<td>4,860</td>
<td>-0.94</td>
</tr>
<tr>
<td>Problem Loans / Gross Loans (%)</td>
<td>3.5</td>
<td>2.1</td>
<td>2.1</td>
<td>1.8</td>
<td>2.0</td>
<td>2.35</td>
</tr>
<tr>
<td>Tangible Common Equity / Risk Weighted Assets (%)</td>
<td>7.2</td>
<td>7.6</td>
<td>7.3</td>
<td>5.8</td>
<td>8.8</td>
<td>7.36</td>
</tr>
<tr>
<td>Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)</td>
<td>24.4</td>
<td>15.3</td>
<td>16.4</td>
<td>17.1</td>
<td>14.0</td>
<td>17.43</td>
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<tr>
<td>Net Interest Margin (%)</td>
<td>5.2</td>
<td>5.4</td>
<td>5.4</td>
<td>4.6</td>
<td>4.2</td>
<td>5.03</td>
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<tr>
<td>PPI / Average RWA (%)</td>
<td>3.6</td>
<td>4.2</td>
<td>3.9</td>
<td>3.4</td>
<td>3.1</td>
<td>3.66</td>
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<tr>
<td>Net Income / Tangible Assets (%)</td>
<td>1.1</td>
<td>1.4</td>
<td>1.6</td>
<td>1.4</td>
<td>1.7</td>
<td>1.43</td>
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<tr>
<td>Cost / Income Ratio (%)</td>
<td>51.9</td>
<td>49.5</td>
<td>50.7</td>
<td>55.1</td>
<td>56.0</td>
<td>52.63</td>
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<td>Market Funds / Tangible Banking Assets (%)</td>
<td>20.7</td>
<td>15.2</td>
<td>16.4</td>
<td>17.1</td>
<td>17.2</td>
<td>17.35</td>
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<tr>
<td>Liquid Banking Assets / Tangible Banking Assets (%)</td>
<td>16.5</td>
<td>17.5</td>
<td>17.7</td>
<td>17.7</td>
<td>18.1</td>
<td>17.57</td>
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<tr>
<td>Gross Loans / Due to Customers (%)</td>
<td>126.4</td>
<td>121.6</td>
<td>121.8</td>
<td>119.6</td>
<td>121.5</td>
<td>122.25</td>
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</table>

Source: Moody’s Financial Metrics

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.moodys.com for the most updated credit rating action information and rating history.
Profile
Bancolombia is a Medellín-based full-service bank that provides individuals, companies and government institutions with savings, investment, financing, factoring, leasing, mortgage banking and capital market products and services.

In addition to its activities in Colombia, the bank also operates in Panama, El Salvador and Guatemala, and also holds smaller operations in Puerto Rico, the Cayman Islands and Peru.

Bancolombia was incorporated in 1945 as Banco Industrial Colombiano S.A. (BIC). In 1998, BIC merged with Banco de Colombia S.A., with the merged entity forming Bancolombia. As of 30 September 2018, the bank’s largest shareholder was Grupo de Inversiones Suramericana S.A..

Detailed credit considerations
Deterioration in corporate loan book put pressure in the bank’s rating
Bancolombia’s 90+ days past due loan (PDL) ratio has increased by 62 basis points in the twelve months ended in September 2018, to 3.55%, reflecting a deterioration in the bank’s corporate loan book whose problematic loans increased close to 100 bps in the same period. This multiplication on corporate problem loans is largely explained by single name exposures to large troubled corporates such as Electrificadora del Caribe S.A. E.S.P. (Electricaribe, unrated), Bogota’s mass transportation system (SITP) and Concesionaria Ruta del Sol S.A.S. (CRDS, unrated) and other clients that have been in watch since the beginning of the year and became delinquent in June 2018. That said, strong reserve coverage of about 1.7 times problem loans partially mitigates deterioration in asset quality.

We also expect that the bank would benefit from the positive momentum of the Colombian economy and that the improvements in and residential mortages loans continue as new vintages present a slower pace of deterioration. Having said that, if overall asset quality continues at the current level, bank ratings would be downwardly pressured.

Low growth maintains capital stable at reduced levels
Bancolombia’s low capital ratio under Moody’s measure reflects mainly the large stock of intangibles which are deducted from calculation. As a result, the tangible common equity (TCE) to risk weighted assets (RWAs) was equivalent to 7.2% as of September 2018, up from 7.1% the year before. The capital improvement in the twelve month period reflects the bank’s capacity to sustain sound internal earnings generation while slowing down significantly the RWA growth.

In terms of regulatory capital, the bank reports ratios reasonably higher than minimum requirements, with a 10.2% Basic capital ratio (versus 4.5% minimum) and 13.7% of Total solvency ratio (versus 9% minimum). In October 2017, the bank issued Tier II notes with loss absorbing features, which however, is not expected to improve the total solvency ratio because the bank is aiming to use the proceeds to repurchase old Tier II subordinated bonds.

Going forward, Moody’s expects the bank to preserve its capital position around current levels due to ongoing slow loan growth pace and hence reduced capital consumption. However, the bank could start depleting capital if the growth accelerates, and therefore, cause a downward pressure on its financial profile.

Credit costs have taken a toll in results
Bancolombia’s net income to tangible assets stood at a moderate 1.1% as of September 2018, down from the three year average of 1.5% (2015-2017). The lower profitability is mainly a reflection of higher credit costs. The loan loss provisions increased to 58% of pre-provision income as of September 2018 from a lower 40% in average of the last three years due to the high delinquencies on corporate portfolios. As of September 2018, Bancolombia’s management stated that Electricaribe 65% provisioned and SITP a 46%, it also mentioned that current coverage for these two loans was deemed as sufficient. If the situation places out in a different way as the bank thinks, these loans could need more provisioning that at the end could take a toll in future earnings.

Broad access to core deposits provides stable funds
Bancolombia has a good ability to fund itself under stress. The bank maintains ample core funding mainly in the form of checking and savings accounts. The bank leverages its ample branch network in Colombia and Central America to attract low cost deposits from its customers.
The bank’s ample core funding partially offsets the bank’s moderate reliance on market funds, at 20.7% of tangible banking assets and low holdings of liquid assets at 16.5% of total assets, as of September 2018. Nevertheless, the bank’s market funds are well diversified between less stable interbank funding and long-term local, foreign currency issuances and very stable development bank funding required for on-lending.

While customer deposits, both retail and wholesale, represent the bank’s most important source of deposits, at around 70% of funding as of September 2018, going forward pressure points on the bank’s funding could arise given the low participation of individuals in the funding, though a common feature among Colombian banks given deep liquidity related to the country’s pension funds and trusts.

Bancolombia’s rating is constrained by a weighted macro profile of Moderate
Bancolombia’s operations are mainly focused on Colombia, representing 73% of its loan book, which has a Macro Profile of Moderate. As a result, the remaining portion of the bank’s loan book is distributed in the following Macro (i) Panama, Moderate Macro Profile, 14% of loans; (ii) Guatemala, Weak Macro Profile, 7% of loans; (iii) El Salvador, Very Weak+ Macro Profile, with the remainder.

» Colombia: Despite the lower expectations of GDP growth, the economy will remain resilient, as it adjusts to lower oil prices, and benefits from its sound fiscal framework and adequate reserve buffers. Our evaluation of Colombia’s macro profile is nevertheless tempered by the country’s low GDP per capita and high inequality. Despite below average indicators for government effectiveness, the country benefits from a favorable investment climate and policy predictability. Colombia faces event risk related to its dependence on oil exports.

» Panama has a dynamic service-based economy with a track record of sustained high growth, supported by an emerging regional financial center and by the vital global role of the Panama Canal. The country’s dollarized financial system has helped ensure macroeconomic stability, but has also raised dependence on offshore financing, and limits space for economic policy making. Strong economic growth has fueled a continued expansion of the banking system over the past five years and credit penetration is among the highest in Latin America.

» El Salvador has a small economy with weak growth prospects, weighed down by low investment and limited improvements in productivity. Although dollarization has helped keep inflation low, it has also limited the economic policy tools available to spur economic growth. The country also suffers from fragile rule of law and widespread security problems. Credit penetration is in line with the average across Latin America, although loan growth has lagged other regional peers as a result of the country’s lackluster economic expansion. Asset risks related to exposures to short-term government securities (LETES) have risen this year as a result of the government’s liquidity strains. Further, consumer lending growth has accelerated in recent years, leaving banks more susceptible to asset quality problems in the event of a more pronounced downturn in the economy, or a decline in remittances.

» Guatemala has experienced steady economic growth over the past several years, but the country still has a low GDP per capita and exhibits weak human development indicators. The country also remains susceptible to political event risk given weak social development indicators and domestic security challenges. In the banking sector, credit conditions characterized by fast loan growth over the past several years, particularly among the untested retail customer segment, and foreign exchange mismatches in borrowers’ balance sheets create important risks to asset quality. Funding risks are driven by high refinancing requirements and modest liquidity buffers in foreign currency.

Support and structural considerations
Government support considerations
We assign a very high likelihood of support from the Colombian government for Bancolombia’s rated deposits and senior unsecured debt. This reflects Bancolombia’s strong market presence and significant participation in the system’s total deposits and loans and hence the material systemic consequences that would result from an unsupported failure. Bancolombia’s deposit rating benefits from two notches of uplift from government support.

Counterparty Risk Assessments
Moody’s Counterparty Risk (CR) Assessment is an opinion of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and
the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank’s covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

**Bancolombia’s long- and short-term CR Assessments are positioned at Baa2(cr)/Prime-2(cr).**

Bancolombia’s CR Assessment is positioned at Baa2(cr), which is two notches above the Adjusted BCA of ba1 and therefore above senior unsecured and deposit ratings, reflecting our view that its probability of default is lower than that of senior unsecured debt and deposits.

**Counterparty Risk Rating (CRR)**

Moody’s Counterparty Risk Ratings are opinions of the ability of entities to honor the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honored. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

**Bancolombia’s long- and short-term CRR are positioned at Baa2/Prime-2.**

**About Moody’s bank scorecard**

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee’s judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.
## Rating methodology and scorecard factors

### Exhibit 3
Bancolombia S.A.

### Macro Factors
**Weighted Macro Profile**: Moderate 100%

<table>
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<tr>
<th>Factor</th>
<th>Historic Ratio</th>
<th>Initial Score</th>
<th>Expected Trend</th>
<th>Assigned Score</th>
<th>Key driver #1</th>
<th>Key driver #2</th>
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<td>Asset Risk</td>
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<tr>
<td>Problem Loans / Gross Loans</td>
<td>3.6%</td>
<td>baa3</td>
<td>← →</td>
<td>baa2</td>
<td>Quality of assets</td>
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<td><strong>Capital</strong></td>
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<td></td>
<td></td>
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<tr>
<td>TCE / RWA</td>
<td>7.2%</td>
<td>caa1</td>
<td>← →</td>
<td>b1</td>
<td>Capital fungibility</td>
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<td><strong>Profitability</strong></td>
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<tr>
<td>Net Income / Tangible Assets</td>
<td>1.1%</td>
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<td>← →</td>
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<td>Earnings quality</td>
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<td>Combined Solvency Score</td>
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<td>Funding Structure</td>
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<td>Market Funds / Tangible Assets</td>
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<td>← →</td>
<td>baa3</td>
<td>Deposit quality</td>
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<td>Liquid Resources</td>
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<td>Liquid Banking Assets / Tangible Banking Assets</td>
<td>17.5%</td>
<td>ba2</td>
<td>← →</td>
<td>ba2</td>
<td>Quality of liquid assets</td>
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<td>Combined Liquidity Score</td>
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<td>ba1</td>
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</table>

### Financial Profile
- Business Diversification: 0
- Opacity and Complexity: 0
- Corporate Behavior: 0

### Total Qualitative Adjustments: 0

### Sovereign or Affiliate constraint: Baa2

### Scorecard Calculated BCA range: baa3-ba2

### Assigned BCA: ba1

### Affiliate Support notching: 0

### Adjusted BCA: ba1

### Instrument class
- **Loss Given Failure notching**: 1
- **Additional Notching**: 0
- **Preliminary Rating Assessment**: baa3
- **Government Support notching**: 1
- **Local Currency Rating**: Baa2
- **Foreign Currency Rating**: Baa2

### Counterparty Risk Rating
- **Counterparty Risk Assessment**: 1
- **Deposits**: 0
- **Senior unsecured bank debt**: 0
- **Dated subordinated bank debt**: -1

### Notes:
- [1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
- Source: Moody’s Financial Metrics
### Ratings

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<thead>
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<th>Moody’s Rating</th>
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<td>Outlook</td>
<td>Negative</td>
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<tr>
<td>Counterparty Risk Rating</td>
<td>Baa2/P-2</td>
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<td>Bank Deposits</td>
<td>Baa2/P-2</td>
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<td>Baseline Credit Assessment</td>
<td>ba1</td>
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<td>Adjusted Baseline Credit Assessment</td>
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<td>Counterparty Risk Assessment</td>
<td>Baa2(cr)/P-2(cr)</td>
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<tr>
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<tr>
<td>Subordinate</td>
<td>Ba3 (hyb)</td>
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<tr>
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<td>Counterparty Risk Assessment</td>
<td>B1(cr)/NP(cr)</td>
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<tr>
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*Source: Moody’s Investors Service*
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