Research Update:

Bancolombia Outlook Revised To Stable From Positive On Weaker Capitalization Prospects; Ratings Affirmed

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Overview

- We no longer anticipate that Bancolombia will be able to strengthen its capital this year, and therefore we're revising the outlook on the bank to stable from positive
- The bank now faces economic fallout, which dampens operating prospects for 2020, but we believe its leading position in Colombia and diversification will lessen the impact.
- We're affirming our 'BB+/B' issuer credit ratings on the bank and on its core subsidiaries, Bancolombia Panama and Banistmo S.A. We're also affirming our 'BB+' issue-level rating on Banistmo's $500 million senior unsecured notes due 2022.
- The stable outlook reflects that the bank's revenue and loan diversification will cushion it from the slowdown, while a sufficient liquidity position will alleviate pressure. Nonetheless, the bank will face earnings decrease and asset quality worsening.

Rating Action

On April 21, 2020, S&P Global Ratings revised its outlook on Bancolombia S.A. y Companias Subordinadas (Bancolombia) to stable from positive, and affirmed its long-term 'BB+' and short-term 'B' issuer credit ratings (ICRs) on the company. At the same time, given that we view Bancolombia Panama S.A. and Banistmo S.A. as core subsidiaries to Bancolombia, we also revised their outlooks to stable from positive and affirmed our 'BB+/B' ICRs on both entities. We also affirmed our 'BB+' issue-level rating on Banistmo's $500 million senior unsecured notes due 2022.

Rationale

Bancolombia's outlook revision reflects that even though its risk-adjusted capital (RAC) ratio was broadly in line with our previous expectation at 5.1% as of December 2019, we anticipate that the ongoing economic stress from the COVID-19 pandemic and oil price plunge will take a toll on the bank's future RAC ratio and operating performance. We expect that a decrease in its profitability due to lower interest rates and asset quality deterioration, coupled with upheld dividend payouts, will outweigh the mild increase in risk-weighted assets (RWAs) amid lower loan distributions in 2020. Consequently, capital sustainability will be impaired, dragging down our forecasted RAC ratio to about 4.6% for 2020 and 2021. In addition, we still consider Bancolombia's quality of capital as low because of the notable amount of foreign currency goodwill in its capital structure that has a larger impact on its total adjusted capital than capital revaluation during exchange rate fluctuations.

Our financial forecasts reflect our base-case assumptions, which include:

- Colombia's GDP to decrease 2.6% in 2020 and grow about 4.1% in 2021;
- Foreign exchange volatility in the next two years: COP3,750 and COP3,825 per $1 for 2020 and 2021, respectively;
- Consolidated loan portfolio growing at about 5% in 2020 and 8% in 2021, including Colombian peso depreciation and commercial loans contingent disbursements;
- Net interest margins (NIMs) decreasing to 5.25% in 2020 from 5.62 in 2019;
- Core earnings to adjusted assets falling to 0.92% in 2020 from 1.46% in 2019 and efficiency levels of about 55% for the next 12 months;
- Dividend payout ratio of nearly 50% in 2020 and about 30% for 2021;
- Nonperforming assets (NPAs) and credit losses (NCOs) at about 4.3% and 2.2%, respectively, fully covered by reserves; and
- No additional business acquisitions for 2020 and 2021.

On the other hand, we view Bancolombia's earnings buffer--defined as the capacity for operating earnings to cover normalized losses--as sufficient, at about 0.85% of our RWAs in the next two years, despite challenges from the COVID-19 pandemic.

The ratings also incorporate the bank's leading market position in the Colombian banking system and sound operations in Central America that will lessen the impact of the recession on its business prospects compared to smaller specialized banks in the region. A well-diversified loan portfolio in terms of geography and sectors will also cushion the deterioration of the loan book and enable manageable asset quality indicators in the next couple of years. The ratings also consider that Bancolombia benefit from a large and stable deposit base that support its funding amid stringent market conditions. In our opinion, liquidity will be tested, but the bank will manage sufficient liquidity position to cover expected and unexpected cash flows in the near future. Its stand-alone credit profile (SACP) remains 'bb+'. We consider Bancolombia Panama and Banistmo as core entities of their ultimate parent, Bancolombia, which views Panama as a strategic growth market and has continued to develop its presence in Central America.

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic and industry risk scores to determine a bank's anchor, the starting point in assigning an ICR. Our anchor for Bancolombia is 'bb+', reflecting the weighted average economic risk of '7' given the countries where the bank has its major loan portfolio exposures as of December 2019: Colombia (71%), Panama (17%), El Salvador (6%), and Guatemala (6%). The industry risk score for Colombian banks is '5', with a positive trend (see "Three Colombian Financial Institution Outlooks Revised To Negative After Similar Action On Sovereign; Ratings Affirmed," published March 30, 2020).

We also consider that the bank's business stability will be less affected by the economic fallout than other smaller specialized banks in the region, thanks to its diversification and position as the largest bank in Colombia and one of the largest financial groups in Central America. Its market share in Colombia was 26.3% in terms of loans as of December 31, 2019, and we consider it unlikely that Bancolombia will lose its leading position in upcoming years. The bank's business diversification and digitalization efforts also makes it less vulnerable to the economic slowdown. Bancolombia continues to participate in nearly all banking business lines. Nevertheless, we expect the bank to reassess its growth strategy based on the highly uncertain environment and the needed support to existing clients. We expect the bank to adjust loan book growth targets to low single digits in an effort to contain asset quality deterioration and focus on liquidity management. Finally, we consider the bank's management to have long experience in the banking sector. In our opinion, it will be fully capable of controlling risks amid the challenging conditions.

In this context, we believe Bancolombia's asset quality will inevitably worsen again after improving in 2019. For the next year, we project NPAs to increase to 4.3% from 3.4% as of December 2019 and net charge-offs to hover around 2.2%. We will monitor the quality of Bancolombia's exposures to the most risky and volatile sectors, including transportation, tourism, energy, and construction, which together represent about 18% of the group's total credit portfolio. Nevertheless, we consider that Bancolombia displays a diversified corporate book and expertise in its risk management that will enable it to keep manageable asset quality indicators in the next couple of years, and comparable with its main Colombian peers. However, if the bank's asset quality worsens beyond our expectations, we could reassess the bank's risk position. The consolidated group enters this adverse environment with ample NPA reserve coverage at 176% as of year-end 2019. We expect it to remain at about 120% in the next couple of years. Furthermore, even if the bank is concentrated in the commercial loans sector, its top 20 largest exposures only represented 6.4% of its consolidated total loan portfolio and 0.57x of its total adjusted capital as of December 2019.

We expect Banconlombia's funding and liquidity profile to remain resilient despite the COVID-19 pandemic and the consequent economic recession. However, we will closely monitor any negative spillover effects from asset quality issues and forbearance periods on its funding and liquidity position. Bancolombia's funding assessment is driven by a high and stable proportion of customer deposits that has shown to be resilient under stressed market conditions and has benefitted from the tendency of investors to shift to safer investments. We expect the stable funding ratio (SFR) to remain about 100%, which we consider in line with its funding assessment and the Colombian banking system, as deposits remain stable and funding doesn't grow significantly. As of Dec. 31, 2019, its funding base hadn't changed significantly, and customer deposits were about 82% of the total funding base. The rest is made up of debt issuances (10%), interbank loans (7%), and a small amount of repurchase agreements (1%). For the next 12 months, we don't expect the bank's funding structure to notably change, because we expect customer deposits to be its main funding source since the bank benefits from its sticky customer base and strong brand.

Bancolombia's liquidity assessment reflects the bank's sufficient liquidity position, which is mainly composed of cash and government securities, and manageable refinancing risk with a satisfactory maturity profile. We believe the bank will focus on liquidity management due to market turmoil, and will successfully meet expected and unexpected cash flows in the following 12 months. We consider that liquidity pressure will be mitigated by central bank contingency measures, and supported by additional resources from available credit lines. In addition, although temporarily, liquidity has increased from additional client deposits. Finally, Bancolombia's liquidity levels are reflected in its broad liquid assets to short-term wholesale funding indicator at 2.5x as of year-end 2019, with a three-year average of 1.9x.

We continue to view Bancolombia as having high systemic importance in the Colombian financial system because of its leading market share in deposits, its importance to the country's payment system, and our belief that the government is supportive of the financial system. The latter results in a moderately high likelihood of extraordinary government support to the bank. Nevertheless, the ratings currently reflect the bank's SACP, because in this case, the government's support would have applied if the differential between the long-term local currency sovereign rating and the bank's SACP was larger than one notch.

Grupo de Inversiones Suramericana S.A. (BBB-/Negative/--) holds about 25% of Bancolombia's equity, making it the largest shareholder. In our view, Bancolombia is moderately strategic for the investment holding company, which according to our criteria grants one notch of support to the company's SACP. However, this is subject to a cap of one notch below the group credit profile (GCP), so we don't apply a notch.

Outlook

The stable outlook on Bancolombia for the next year reflects our expectation that although they will worsen, it will keep manageable asset quality metrics and sufficient liquidity cushions to meet financial obligations, despite the ongoing pandemic and global recession. Additionally, we expect Bancolombia to keep its leading business position in Colombia and its solid franchise in Central America.

The stable outlooks on subsidiaries Banistmo S.A. and Bancolombia Panama reflect the outlook on Bancolombia. The ratings on the subsidiaries will move in tandem with those on their parent due to their core status.

Downside scenario

A downgrade of the bank over the next year would result from a combination of a downgrade of Colombia and the worsening of the bank's credit fundamentals, driven by asset quality deterioration or by liquidity tightening beyond our base-case scenario, leading us to revise its SACP downward.

Upside scenario

We could upgrade Bancolombia if it withstands the depressed economic conditions without a sharp weakening of its asset quality metrics, while its RAC ratio increases and remains consistently above 5.25%. However, we do not see this scenario as likely in the next 12 months.

Ratings Score Snapshot

Bancolombia, S. A. y Companias Subordinadas

Issuer Credit Rating: BB+/Stable/B

SACP: bb+

Anchor: bb+

Business position: Strong (+1)

Capital and earnings: Weak (-1)

Risk position: Adequate (0)

Funding: Average (0)

Liquidity: Adequate

Support: 0

GRE support: 0

Group support: 0

Sovereign support: 0

Additional factors: 0

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Bancolombia, S. A. y Companias Subordinadas		
Bancolombia Panama S.A.		
Banistmo S.A.		
Issuer Credit Rating	BB+/Stable/B	BB+/Positive/B
Ratings Affirmed		
Banistmo S.A.		
Senior Unsecured	BB+	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.