Bancolombia (CIB)

FINANCIALS – Diversified Banks

Stock Statistics

Ticker	CIB
Exchange	NYSE
Financial Year End	December

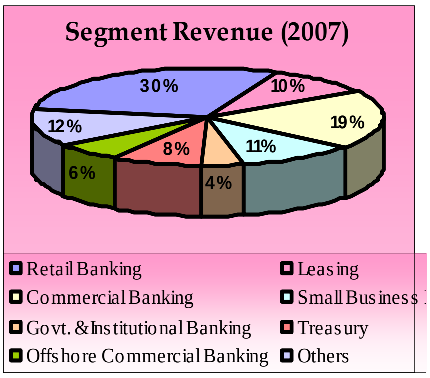
Market Price *	$17.58
Market Cap (bln) *	$3.46B
52-Week Hi / Low	$44 / $15
Average Daily Volume	> 400,000

* As of previous day close

Source: Reuters

Company Description

Bancolombia (CIB), headquartered in Medellin, Republic of Colombia, provides traditional as well as non-traditional banking products and services to large industrial companies, small and medium-sized companies, construction customers and individuals in Columbia and internationally. CIB provides commercial and retail banking services including savings and current accounts, debit and credit cards, pension plans, deposits, mortgages, remittance delivery, consumer and commercial loans, and other banking operations together with asset management services. CIB is the largest bank in Colombia, with > 700 branches and > 1600 ATMs. CIB operations outside Colombia are in Puerto Rico, El Salvador, the U.S., Panama and the Cayman Islands (that added 14% to its total revenue in 2007). In May 2007, CIB completed the acquisition of Banagricola which added ~ 95,000 clients and 94 branches.



__Note__: In the 155-variable model we use on our initial screen, there is an inverse relationship between a stock's price movement and it's ranking on the model. Therefore, we oftentimes recommend out-of-favor stocks that may not have quite reached their bottom.

Investment Recommendation – Buy / 3-5 year target: $44

Upon returning from an 18-day vacation in Colombia ten days ago, I decided to prepare (with my assistants) a report on Bancolombia. It was a stock I had my eye on for a couple of years, but it was always trading at a premium that I wasn't willing to pay. Now that the shares are 60% off their all-time high from May 2008, and the P/B has been slashed in half (to 1.4X), I decided it was worth researching. Conservatively run CIB is not exposed to the same problems that U.S. banks (and banks in other countries) are exposed to. The CIB stock price is down mainly because of the rebound in the US$ (vs. the Peso) and due to the fact that when markets go down, good companies sell off as well. The Colombian Peso bottomed out at 3000 (per US$) during their last recession (2003). It then rallied during the next five years and peaked at 1700 in June 2008. It has since stumbled and is now at 2565. CIB has a strong __and understandable__ balance sheet. Their use of derivatives is restricted and NIM should remain flat (or slightly down) in 2009 vs. 2008. 14% of CIB shares are owned by Colombian pension funds and the shares are only down 20% in the local currency. CIB ranked # 27 (out of 200) in the recent run of ADR stocks through our 155-variable computer model. If we look out 3-5 years the company should easily be able to deliver US$4.00 per ADR. I am attaching an 11X multiple to that in order to arrive at the $44 target -- that is actually where the stock traded at its peak in Q2 2008. CIB has historically traded at 0.8X-1.2X the S&P multiple; it is now at 0.4X. The shares have historically traded at 10X-20X EPS … CIB is now trading at just 6X. The multiple on book value is also near a historic low at 1.4X.

Investment Summary

- **Diversified portfolio** – CIB has a diversified portfolio of products and services including traditional service such as time deposits, savings accounts, checking accounts and credit cards as well as non-traditional products such as pension fund services, leasing, brokerage services and investment banking. Decline in demand for traditional products will be offset by increase in demand for non-traditional products. We anticipate that CIB's stable financial position and diversified portfolio will offer a number of growth initiatives to build long-term shareholder value.
- **Expansion and cost containment strategy -** CIB intends to aggressively enhance its visibility and reach over the next couple of years. For FY09 CIB has decided to further expand its ATM network by 300 units and has earmarked $120 mln for refurbishing its IT systems over the next three years. At the same time, the board of directors has approved the construction of new headquarters with an area of 125,000 square meters with a capacity to allocate 4,200 employees which is expected to provide savings from consolidating its human resources in one place from 15 locations currently, as well as tax breaks from the investment. CIB has also planned the sale of up to US$434 mln subordinated bonds to finance its existing businesses and for general corporate purposes. In January 2007, CIB started its operations in Peru as part of its international expansion strategy. These steps will help CIB report better revenues and earnings going forward.
- **Central bank's stimulus plan –** The current economic slowdown in Colombia coupled with high inflation rates and the prevailing liquidity crunch, forced the central bank and government to take various monetary measures and reduced the existing reserve requirement in an attempt to inject sufficient liquidity. Consequently, after cutting the interest rate to 9.0% from 9.5% on January 30, 2009, the central bank indicated that it will keep cutting lending rates to stimulate the slowing economy. The decline in interest rates should not have a significant negative impact on net interest margins but will positively impact the loan growth and its asset quality. Also, Presidential elections are expected to take place in 2010 and we believe the formation of a new government will put forward stimulus plans to bolster the economy which in turn may benefit CIB.

Investment concerns continued on Pages 2 & 3.

- **Rising Non-performing assets** – CIB's NPL ratio has risen for eight consecutive quarters. Rising NPA (banker's credit risk) increased 68% from Ps 557 bln to Ps 939 bln, posing a challenge to the asset quality at CIB. Bancolombia reported Ps 132 bln as charge-offs in 3Q08. In FY06 past due loans were Ps 569 bln as compared to Ps 1,105 bln in FY07. In 3Q08, past due loans increased by 8.8% versus 2Q08. Rising NPA in the loan portfolio could materially and adversely impact its operations and financial position and if the quality of assets decline at a rate faster than expected, it could result in pressure on CIB profitability.
- **Interest rates** – In January 2009, the central bank reduced the interest rate from 9.5% to 9.0%. Previously, it had raised the lending rate 16 times (from mid-2006) in an attempt to control inflation, which hit 7.7% in FY08. Changes in interest rates could have an impact on the net interest margin, interest income and interest expense, which is inherent in the CIB balance sheet. It can also impact ability to originate loans, attract and retain deposits.
- **Dependence on economic growth** – Decelerating or accelerating economic growth could have a major impact on the loan portfolio of the bank. GDP growth has slipped during the current global recession from ~ 7% last year to ~ 3%. Slow growth due to global turmoil could have an adverse impact on the operations -- especially lending.

Peer Benchmarking

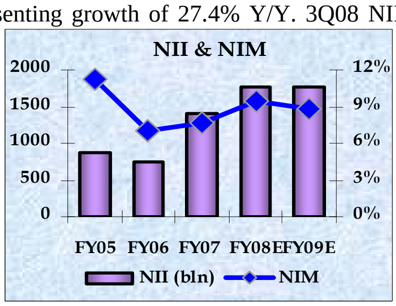
Tick / Mkt Cap	HQ	P/E (ttm)	5-Yr. ROE	EV/EBITDA	P/Book
CIB / $3.7B	Colombia	4.5X	29.4%	1.6	1.3X
BBV / $32.7B	Spain	3.8X	22.0%	-3.6	0.7X
C / $19.0B	USA	N/A	15.0%	N/A	0.2X
BAP / $3.2B	Peru	8.8X	15.9%	-7.6	1.8X

Financial Analysis

Management guidance – CIB has a very conservative outlook of loan growth for FY09 and expects to maintain the net interest margin at or slightly below current levels of 7.7% in FY09-FY10. IT CapEx should be ~ $120 mln and it would be split over three years. Management has stated that it expects to establish ~ 300 new ATMs in 2009, representing growth of approximately 15%.

Reuters estimates per ADR – Reuters estimates FY08 revenue at $2.67 bln, net income at $615 mln and EPS at **$3.41**. For FY09, consensus estimates for revenue is at $2.41 bln, net income at $633 mln and EPS at **$2.99**. In FY10, revenue is estimated at $2.63 bln, net income at $770 mln and EPS at **$3.91.**

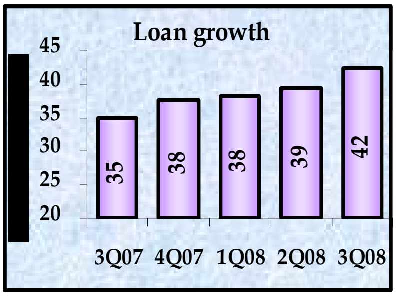
Net interest income maintains growth pace – CIB reported net interest income (NII) year-to-date through 09-30-08 of Ps 2,575 bln versus Ps 2,021 bln, representing growth of 27.4% Y/Y. 3Q08 NII totaled Ps 921.1 bln versus Ps 716.1 bln in 3Q07, an increase of 28.6% Y/Y, and 7.4% sequentially. This growth in NII was spurred by an increase in interest income on account of higher interest rates due to re-pricing of loans. The increase in NII supported the bottom line which grew 16% Y/Y.



CIB 3Q08 results remain unchanged by the sharp depreciation of peso, as the bank had hedged a significant portion of its currency exposure.

Steady net interest margin – Net interest margin improved to 7.69% in 3Q08 compared to 6.99% in 3Q07 and 7.51% in 2Q08, reflecting an increase of 70 basis points Y/Y and 18 basis points sequentially. Based on a series of regulatory tightening moves by the central bank through lowering the reserve requirement level and reducing interest rates, we believe that going forward margins may take a slight hit in FY09.

Slower loan growth – As of 09/30/08, the CIB loan portfolio comprised of corporate loans (Ps 20,268 bln; Y/Y up 13.4%), retail and small and medium-sized enterprise (Ps 13,358 bln, up 30.7%), financial leases (Ps 5,289 bln, up 22.1%) and mortgage loans (Ps 5,153 bln, up 23.2%). Even though there is declining GDP growth, bank loans have grown, albeit slowly to Ps 42,289 bln in 3Q08, registering growth of 19.3% Y/Y and 7.5% Q/Q. Slower loan growth is partly due to the economic slowdown and partly due to higher interest rates in Colombia. The government is taking monetary initiatives to ease liquidity by lowering interest rates and reducing the reserve requirement which could offset some of the GDP impact.



Non-performing assets on rise – CIB has experienced an increase in non-performing assets to Ps 938.6 bln in FY07 from Ps. 556.6 bln in FY06. Tougher economic times and a continued rise in lending rates have contributed to the increase in non-performing assets. With regulators looking at easing interest rates and working on ensuring liquidity in the system, the NPA growth may be contained somewhat.

Efficiency ratio – Despite the current market conditions, CIB reported an efficiency ratio of 46.4% in 3Q08 as compared to 50.3% in the same period last year. As we expect some slowdown in revenues in the coming quarters based on economic turbulence, we believe that bank efficiency could deteriorate a bit further in FY09 before stabilizing in FY10.

Financial Summary – per share

	FY2007 A	FY2008 E	FY2009 E	FY2010 E
Summary Income Statement				
Net Interest Income	1,393.9	1,758.2	1,763.9	1,795.8
Non-interest Income	733.2	975.2	910.7	930.8
Operating Income	2,127.1	2,733.4	2,674.7	2,726.6
Credit Loss Provisions	296.3	492.5	492.5	486.3
Operating Expenses	1,092.6	1,243.1	1,247.8	1,256.9
Net Income	539.3	666.9	612.4	637.1
EPS	$0.71	$0.85	$0.78	$0.81
Summary Balance Sheet				
Cash and equivalents	2,595.0	2,915.6	3,613.8	3,612.2
Net Loans	17,990.0	18,515.9	20,006.2	21,830.6
Investments	2,777.5	2,824.0	3,086.9	3,296.8
Total Earning Assets	23,362.5	24,255.5	26,707.0	28,739.7
Intangibles	485.0	448.0	428.9	393.8
Deposits	17,061.2	17,346.8	18,961.6	20,251.1
Borrowings/Debt	3,430.7	3,595.5	3,930.2	4,197.4
Shareholders Equity	2,626.4	2,702.5	3,001.6	3,228.7
Total Assets	25,884.8	27,068.3	29,635.6	31,674.0
Key Ratios				
NII Growth Y/Y	87.9%	26.1%	0.3%	1.8%
EPS Growth Y/Y	61.4%	19.6%	-8.5%	4.0%
Net Interest Margin	7.60%	9.50%	8.80%	8.20%
Return on Assets	2.53%	2.52%	2.16%	2.08%
Return on Equity	24.47%	25.44%	21.79%	20.74%
Equity to Assets	10.15%	9.83%	9.98%	10.06%
NPAs/Loans	2.93%	3.65%	3.90%	3.90%
Tier 1 Capital Ratio	10.14%	9.18%	9.40%	9.26%

$ million, except EPS

NM: Not Meaningful

Significant Developments

(02/13/09) **Colombia Bank signals more rate cuts** – Policy makers said the “time is right” to keep cutting lending rates to help stimulate the economy and that the speed of reductions will depend on inflation. Previously, the Central Bank cut its rate to 9.0% from 9.5% on January 30, 2009.

(02/13/09) **Bancolombia reported unconsolidated net income** of Ps 56.1 billion for the month ended January 31, 2009, increasing 19.2% as compared to the same period of 2008.

(01/31/09) **Dividend payment** – Board of directors propose to place in the General Shareholders Meeting, an approval for dividend payment of Ps 156 per share and per quarter on April 1st, July 1st and October 1st of 2009 reflecting a significant increase of 9.9% as compared to dividends paid in 2008. The dividend yield is now at 5.4%.

(01/27/09) **CIB plans to sell Ps 1 trillion in Colombia Bonds** – CIB has planned to sell 1 trillion Colombian pesos ($434 million) in several tranches in order to finance its existing businesses.

(12/02/08) **Mortgage Loans sold to Titularizadora Colombiana** – CIB sold mortgage loans worth 84 bln Colombian pesos ($36 million) to Titularizadora which were secured by Titularizadora through the issuance of mortgage backed securities (TIPS E-4).

(12/01/08) **67% interest sold in real estate property** – CIB sold 67% of its interest in real estate property to CMB for a sale price of approximately $9.7 mln.

(10/27/08) **Authorization to acquire** – CIB agreed to acquire 25% of assets and liabilities of Compania de Financiamiento Comercial Sufinanciamiento ("Sufi"), a subsidiary of Bancolombia.

(06/20/08) **Moody’s upgrades CIB** – Moody’s upgraded Bancolombia’s foreign currency deposit rating and foreign currency subordinated bond rating to Ba2 and Baa3 from Ba3 and Ba1 respectively.

Standpoint Research 155-Variable Model / Quantitative Analysis with Fundamental & Subjective Overlay

This recommendation was generated from our recent ADR-200 report. Please refer to the "Legend" sheet in our Excel reports for the color code and description of all 155 variables used in our model. The 155-variable scoring is summarized in the 32 categories below (from roe through peg). The number in each of the cells, is the rank out of 200 stocks in the respective category. The seven cells to the right of the peg cell are coded and for internal use. A weak score on P/S (ps) can be offset by a strong score in Net Profit Margin (npm). A weak score on return on equity (roe) can be offset by a strong score on price-to-book (pbk). A weak score on technical indicators (especially at the extremes), is looked at positively if it is combined with strong scores on fundamentals and valuation.

rank	ticker	roe	roa	roc	ebitda	npm	acct	eps m	rev gr	eps gr	beta	debt	stab gr
27 / 200	CIB	95	146	114	35	55	10	53	52	48	87	129	75

div I	pbk	base	rel-ma	inside	safe	pcf I	pcf II	fcf	div II	rel str	pr mo	ps	rel ps	off hi-lo
31	102	94	74	1	1	58	64	62	60	124	81	77	117	61

pred	pertix	perhis	blend	peg	deducts	t val	t fund	t prop	t misc	t tech	t score
142	76	72	36	27	4788	1300	2112	883	214	279	67.49%

Upon returning from an 18-day vacation in Colombia ten days ago, I decided to prepare a report on Bancolombia. It was a stock I had my eye on for a couple of years, but it was always trading at a premium that I wasn't willing to pay. Now that the shares are 60% off their all-time high from May 2008, and the Price-to-Book has been slashed in half (from 3.0X to 1.5X), I decided it was worth researching. Before writing about Bancolombia, I think a bit of background information on Colombia is appropriate.

Colombia -- Overview

Colombia is as beautiful a country as I have ever been to (out of more than 20 countries). The people are friendly and genuine; it is a young population – one-third under age 18 and only 6% over age 65. In Japan for example, more than 20% are over age 65. This is to a certain extent a function of life expectancy. That being said, I prefer to invest in a young population than an aging one. Colombia is 26th in size (out of more than 200 countries) at 441,000 square miles, and they are 29th according to population (44,000,000). Under President Alvaro Uribe (2002-current), crime is down ~ 75%! Under his presidency, the Revolutionary Armed Forces of Colombia (FARC) have suffered a series of military defeats, and the main paramilitary groups have gone through a de-mobilization process. Colombia's economy grew steadily in the latter part of the twentieth century, with GDP increasing at an average rate of > 4% per year during the 1970-1998 timeframe. The country suffered a recession in 1999, and the recovery was long and painful. In recent years growth has been impressive, reaching 8.2% in 2007, one of the highest rates of growth in Latin America. The Colombian Stock Exchange climbed from 1,000 points (at its creation) in July 2001 to over 7,300 points by November 2008.

According to the IMF, in 2007 Colombia's nominal GDP was US$202.6 billion (37th in the World and 4th South America). Adjusted for 'purchasing power parity', GDP per capita stood at ~ $8,000, placing Colombia in 82nd place (out of more than 200 countries). Unfortunately, as is the case in many South American (emerging and developing) countries, the wealth is unevenly distributed among the population -- In 2003, the richest 20% of the population had a 63% share of the income and the poorest 20% just 2.5%. Approximately 20% of Colombians live on less than US$3.00 a day. Government spending is 38% of GDP, with nearly 25% going towards servicing the country's relatively high government debt, estimated at 52.8% of GDP in 2007. Other problems facing the economy include weak domestic and foreign demand, the funding of the country's pension system, and 11% unemployment. Inflation has remained relatively low in recent years, standing at 5.5% in 2007.

Colombia is rich in natural resources, and its main exports include petroleum, coal, coffee and other agricultural produce, and gold. Unofficially, illegal drugs are also a major export, with approximately 75% of the world's cocaine produced in Colombia -- estimated to account for between 1% and 3% of the country's GDP. Colombia is also known as the world's leading source of emeralds, and more than two-thirds of cut flowers imported by the United States are Colombian.

Regarding Bancolombia --

Colombia's macro-economic stability is our main concern with the bank. The asset quality looks good and capital adequacy looks good as well. Being the biggest bank in Colombia, it has a strong competitive advantage. Sudden deterioration of asset quality, nationalization or near zero equity valuation would **not** seem to be concerns (as we have seen with some American and European banks). This is a conservatively and well-run bank and as we see on the color-coded table for CIB (above), there is not a single red mark on their profile. The mark on 'roa' (return on assets) can be disregarded as that is relative to 200 stocks spread out across all ten sectors. The pre-tax ROA at CIB is 1.9% and that is actually quite good for a diversified bank. The second orange mark has to do with earnings predictability. The share price is closely tied to the foreign exchange (Colombian Peso) rate versus the US$ – the rate is quite volatile and that makes it difficult to forecast EPS accurately. In my discussion with a CIB representative, he stated that the recent drop to 2565 (Pesos per $US) has probably been an over-reaction and they expect the rate to stabilize at or near 2250.

Colombia's macro-economic stability is a concern, but not a serious one. Alvaro Uribe's administration is doing a great job, and lessons were learned from the collapse six years ago. During the late 1990s and early 2000s, Colombia's financial system witnessed a near collapse with numerous bank failures. The capitalization ratio of the system fell dramatically, and so did profitability and liquidity. The number of banks fell from 110 (Jun-98) to 57 (Dec-2000). Total assets in the (financial) system declined by 20%. Crime is down sharply under Uribe – an unexpected reversal in that trend may negatively impact the current prosperity and stability in the country.

Both inflation on one hand and the interest rate on the other are currently at manageable levels. However, Colombia has a history of economic imbalances with interest rates and inflation. The interest rate topped 35% in 1998 and inflation reached to 8.2% in middle of 2008. Both high interest rates and high inflationary trends may have very severe negative impact on asset growth and asset quality at CIB.

Banking in Colombia presently is a virtual duopoly. Bancolombia is the larger one (of the two), while Banco de Bogota is the country's second-largest bank. CIB has approximately 20% market share across most product segments. In certain product lines such as payment cards acquiring and leasing, the bank has a > 40% market share. Bancolombia is controlled by the Colombian conglomerate, Grupo Empresarial Antioqueno.

Real interest rates in Colombia had been historically high. Banks booked high margins by accessing low cost deposits and investing in relatively high yield government bonds. As the real interest rates started falling in the beginning of this decade, Colombian banks, including Bancolombia, aggressively chased corporate loans. Loans, which constituted ~ 50% of Bancolombia's assets in 2002, grew fast in order to capture a larger share of the assets -- 72% in 2007. These loan assets, with a higher risk profile versus government bonds, pushed up the credit risk. From 2004-2006 the write-downs were at a low-level with 0.53% of loans (on average). However, the write-down (percentage) increased in 2007-2008.

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Bancolombia grew by acquisition in 2005-2007. In 2007, assets increased 51%, including 20% internal growth. Bancolombia recently augmented the capital base by issuing $480 million of preferred stock. This along with $400 million of long-term debt was used to finance the $900 million all-cash acquisition of Banagricola. On a consolidated basis, the capital adequacy ratio is at a comfortable 11.4% as of 30-Sep-08.

In Q3, 2008 Bancolombia recorded net income of Ps 367.0 billion, an increase of 15.9% versus Ps 316.7 billion for the quarter ended September 30, 2007. Net income for the first nine months of 2008 was 996.2 billion, representing an increase of 30.3% as compared to the same period of 2007. As of September 30, 2008, CIB gross loans totaled Ps 42.3 trillion, increasing 19.3% versus 3Q07 and 7.5% versus the quarter ended June 30, 2008. As in previous quarters, loan growth has slowed due in part to a lower level of economic growth and higher interest rates in Colombia.

On February 13, CIB reported results for January 2009 -- Unconsolidated net income of Ps 56.1 billion for the month ended January 31, 2009, increasing 19.2% as compared to the same period of 2008. Net interest income, including investment securities, totaled Ps 233 billion in January 2009, increasing 35.2% as compared to the same period of 2008. Net fees and income from services in January 2009 totaled Ps 64.3 billion, which represents an increase of 8.4% as compared to the same period of 2008. Other operating income was negative in the amount of Ps 3.1 billion for January 2009, representing a decrease of 121.8% as compared to the same period last year. Net provisions totaled Ps 82.3 billion in January 2009, which represents an increase of 266.5% as compared to the same period of 2008.

Bancolombia's (unconsolidated) level of past due loans (i.e. loans overdue for more than 30 days) as a percentage of total loans amounted to 3.64% as of January 31, 2009, and the ratio of allowances to past due loans increased to 137.9% as of the same date. Operating expenses totaled Ps 156.3 billion in January 2009, increasing 15.8% as compared to the same period of 2008. Total assets (unconsolidated) amounted to Ps 39.7 trillion, loans amounted to Ps 28.1 trillion, deposits totaled Ps 25.0 trillion and Bancolombia's total shareholders' equity amounted to Ps 6.0 trillion. According to Colombia's national banking association, Bancolombia's market share of the Colombian financial system as of January 2009, was as follows: 19.1% of total deposits, 22.0% of total net loans, 20.9% of total savings accounts, 22.5% of total checking accounts and 14.9% of total time deposits.

Three-year and five-year historical revenue and EPS growth all exceed 20% at CIB. Beta versus the S&P-500 is just 1.1X. Long-term debt-to-capital is 40%. The shares are trading at 3X cash flow and 0.6X revenues with a net profit margin of 14%. Revenues should be flat to slightly higher in 2009 versus 2008. Pre-tax return on assets is 1.9%, versus 1.5% at Brazil's Banco Bradesco (BBD), 1.8% at Banco de Chile (BCH), and N/A at BBV (Spain). We compared CIB to BBD, BCH, and BBV and the stock (CIB) ranks favorably on most variables.

There has been a significant increase in the dividend in each of the last five years. The yield is currently at 5.4%. If we look out 3-5 years the company should easily be able to deliver $4.00 per ADR. I am attaching an 11X multiple to that in order to arrive at the $44 target -- that is actually where the stock traded at its peak in Q2 2008. CIB has historically traded at 0.8X-1.2X the S&P multiple; it is now at 0.4X. The shares have historically traded at 10X-20X earnings; they now trading at just 6X. The multiple on book value is also near a historic low at 1.3X.

End of report

Disclaimer:

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