Bancolombia 5.95% Due 2021

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Colombia Overview

The Colombian economy has benefited from the recovery in oil prices. Gross Domestic Product is expected to come in at 2.8% and 3.2% for 2018 and 2019, respectively. One of the major driving forces behind growth over the next few years will be investment. The government's 4G infrastructure investment program has been slow to advance but should support growth. Private investment has been aided by the recent tax reform incentives, exchange rate and interest rate movements.

The World Bank has stated that fiscal consolidation efforts are critical for creating fiscal space for the post-conflict related spending and keeping a minimum level of public investment, while complying with the fiscal rule. The rule requires that the Central Government deficit declines by 2.6% of GDP by 2022 to 1% of GDP, with the structural deficit declining by 0.9% percent of GDP to 1%. The continued compliance with the fiscal rule, instituted for the first time in 2012, shows that fiscal management remains strong. Colombia's flexible exchange rate regime is one of the first lines of defence against external shocks. Consistent with the inflation-targeting regime, the flexible exchange rate acted as the main shock absorber, depreciating more than 70% between mid-July and early 2016, before appreciating slightly in 2017.

Colombians went to the polls on Sunday, May 27, 2018 to elect a new president. However, no candidate was able to secure a sufficient majority, consequently there will be a second round vote on June-17th. The winning candidate must obtain half plus one of the total valid votes. The winner will govern for a maximum period of four years, starting on August 7, 2018. Any major shift in policy by the incumbent could derail gains and negativity affect the external profile of the country. Notwithstanding, Colombia remains a strategic economic partner and military ally of the USA.

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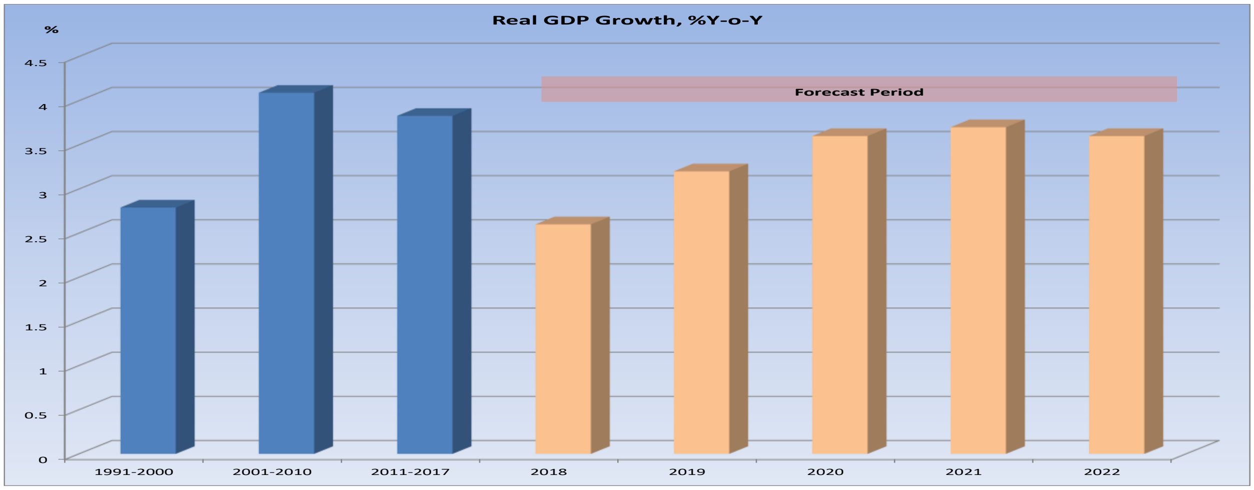
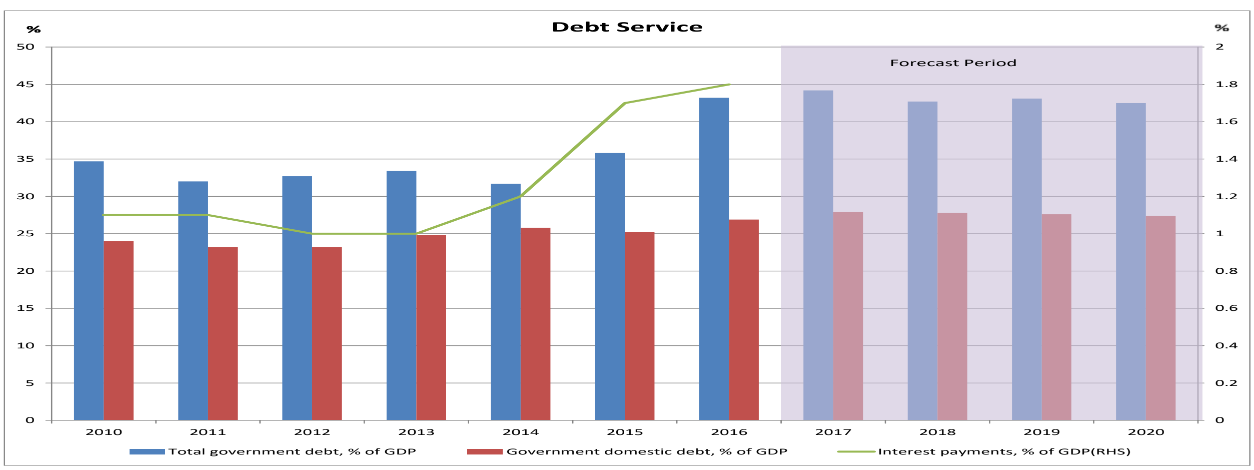
Graph 1: Real GDP Growth



Source: JMMBIR, IMF, BMI

Economic growth in the country slowed to 2.8% in 2017. Economic activity was impacted by the 3% increase in the VAT (Value Added Tax). Government consumption remained subdued due to continued fiscal consolidation efforts. On the supply side, industrial production declined in 2017, primarily due to weak performance in the extractive industries, as gold, platinum and silver output plunged. Further, oil and gas production declined nearly 4% and refining output also showed some reduction. The manufacturing of textiles and beverages declined. Financial and social services contributed the most to growth, while the agriculture sector expanded 4.9% as the effects of the El Niño phenomenon dissipated and the livestock sector expanded more rapidly.

Graph 2: Gross Debt, Revenue and Interest ratios



Source: JMMBIR, IMF, BMI

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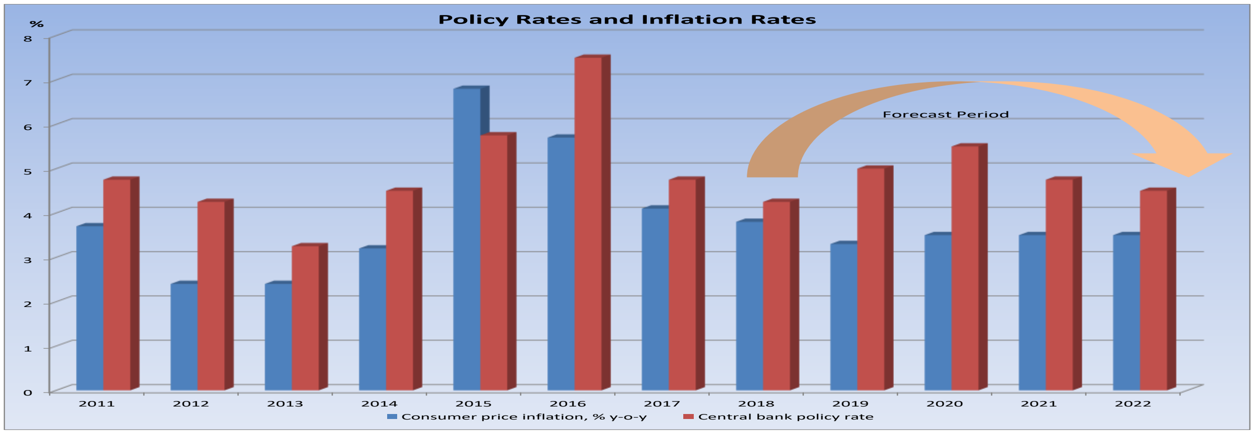
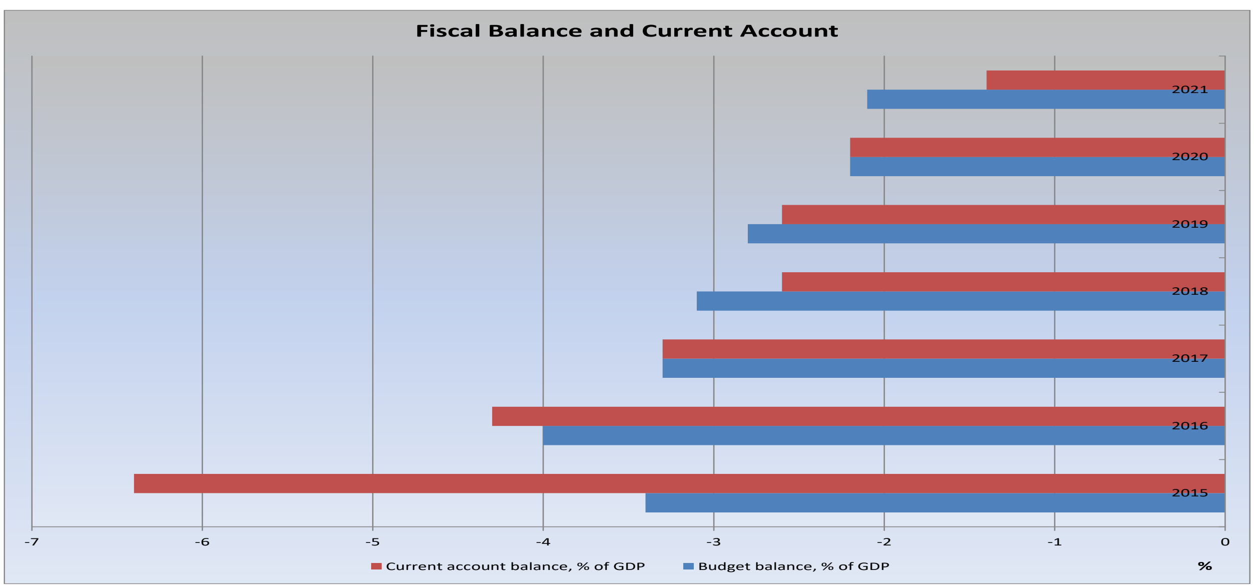
Graph 3: Policy Rates and Inflation rates



Source: JMMBIR, IMF, BMI

According to the National Administrative Department of Statistics, this marks the fourth straight month of decline in inflation, with the rate now nearing the ideal rate of the Colombian central bank, which has set a target range of between 2% and 4%. The consumer price index (IPC) rose by just 0.24% from February to March, putting the 12-month inflation rate at 3.14%, down from 3.37% in February 2018. Notwithstanding, Colombia's central bank lowered its benchmark interest rate by 25 bps to 4.25% on April 27 2018 in a bid to boost economic activity.

Graph 4: Fiscal Balance and Current Account



Source: JMMBIR, IMF, BMI

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In December 2016, the Colombian Congress approved a 3% increase in the value-added tax (VAT) that took effect in 2017. The reform included measures to improve tax buoyancy by simplifying the fiscal regime, eliminating various loopholes, and taking steps to stem tax avoidance and promote formalization of the economy. The reform will gradually reduce the corporate income tax rate to enhance competitiveness.

General government debt, net of liquid assets (not including international reserves), is expected to rise to 39% of GDP in 2021 from 36.6% of GDP in 2017. Colombia's external profile reflects high external debt and terms of trade volatility. Standard and Poor’s expect current account deficits (CADs) to average just below 3% of GDP during 2018-2021, down from 6.4% in 2015. Notwithstanding the improvements in CADs, external debt is still expected to remain high. Colombia's external debt stock net of public and financial-sector external assets is expected to exceed 110% of CAR in 2018 but decline gradually in the next three years. Further, Colombia's export base is recovering slowly, but is expected to remain below the peak levels seen during the commodity boom.

Company Overview

Bancolombia (BCOLO), Colombia's largest bank by assets and shareholders' equity, is a full service financial institution offering a broad range of banking products and services – including corporate and government banking, treasury, mortgage banking, and personal and SME banking – to individual and corporate clients. The bank's offerings include saving and checking accounts, investment products, debit and credit cards, pension plans, mortgage loans, consumer and commercial financing, remittance services, payment and collection, and foreign trade. Bancolombia has a 20% market share in Colombia's banking sector and has a strong presence in the corporate, mortgage, government, retail, and middle-market segments. Bancolombia's non-banking subsidiaries provide ancillary services such as stock brokerage, investment banking, leasing, factoring, consumer finance, fiduciary and trust services, asset management, pension fund administration, and insurance. In addition, the group owns El Salvador's largest bank Banagrícola, off-shore banking subsidiaries in Panama, Peru, the Cayman Islands and Puerto Rico, and an agency in Miami, Florida. Bancolombia was formed in 1998 as a result of a merger between Banco de Colombia and Banco Industrial Colombiano. It is headquartered in Medellín, the country's second largest city, and is controlled by Colombian holding company Grupo de Inversiones Suramericana.

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Financial Analysis:

Table 1: Income Statement

US$M	2009	2010	2011	2012	2013	2014	2015	2016	2017
Interest & inv't income	3,021.40	2,628.88	3,235.75	4,290.40	4,386.95	4,374.02	4,042.86	4,977.35	5,426.02
Interest Expense	1,229.50	829.05	1,106.16	1,611.02	1,671.61	1,586.74	1,485.20	1,987.51	2,112.06
Net Interest Income	1,791.90	1,799.82	2,129.59	2,679.39	2,715.35	2,787.27	2,557.65	2,989.84	3,313.96
Trading Account Profit	48.67	129.34	158.55	160.38	84.21	286.44	239.27	327.68	338.05
Commissions & Fees Earned	772.44	912.41	1,005.36	771.46	1,158.74	1,251.21	1,026.40	1,078.69	1,215.43
Other Operating Income	95.89	112.12	212.30	586.58	300.27		372.72	373.12	433.54
Net Revenue	2,708.89	2,953.69	3,505.80	4,197.81	4,258.56	4,324.92	4,196.05	4,769.33	5,300.98
- Provisions for Loan Losses	516.82	270.40	323.08	596.87	622.51	422.98	613.39	868.05	1,175.38
Net Revenue After Provisions	2,192.07	2,683.29	3,182.72	3,600.94	3,636.06	3,901.94	3,582.66	3,901.28	4,125.60
Non-Interest Expense	1,468.95	1,748.92	2,122.22	2,495.38	2,698.42	2,765.02	2,465.53	2,624.79	2,872.33
Operating Income	723.12	934.36	1,060.50	1,105.56	937.64	1,136.92	1,117.13	1,296.28	1,253.27
- Net Non-Operating Losses (Gains)	- 88.90	- 98.60	- 101.87	- 104.76	- 106.18	- 419.73	- 72.97	- 6.69	- 13.76
Pretax Income	812.02	1,032.97	1,162.36	1,210.32	1,043.82	1,556.65	1,190.11	1,302.97	1,352.96
- Income Tax Expenses	216.36	268.20	254.88	259.93	223.32	369.87	238.80	386.41	419.70
Income Before XO Items	595.65	764.76	907.48	950.39	820.50	1,186.78	951.30	916.56	933.26
- Extraordinary Loss Net of Tax						- 31.52	- 8.28	- 53.68	
- Minority Interests	7.06	6.97	6.15	3.18	9.30	21.41	33.11	29.43	47.16
Net Income	**588.59**	**757.79**	**901.33**	**947.20**	**811.21**	**1,196.89**	**926.48**	**940.82**	**886.10**
- Total Cash Preferred Dividends	82.94								
Net Inc Avail to Common Shareholders	**505.65**	**757.79**	**901.33**	**947.20**	**811.21**	**1,196.89**	**926.48**	**940.82**	**886.10**

Source: Bloomberg, JMMBIR

Bancolombia reported net earnings of US$886.1M for the year ended December 2017 relative to a net profit of US$940.82M the previous year. There was a 9% improvement in net revenue during the 2017 review period relative to 2016. The main drivers behind this growth were interest income and commission and fees income. The increases in interest expense and non-interest expenses influenced a 5.8% dipped in net earnings for the 2017 financial year end.

Bancolombia 5.95% Due 2021

Table 2: Balance Sheet

US$M	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
+ Cash & Near Cash Items	691.41	1,793.17	1,720.79	3,608.59	2,768.68	3,987.10	4,042.65	5,942.51	4,710.59	4,503.12	5,404.36	5,198.20
+ Interbanking Assets	204.29	797.70	777.35	100.52	439.16	382.41	580.07	2,070.31	955.98	1,355.32	1,414.11	884.90
+ Short-Term Investments	2,071.97	2,043.78	2,144.40	2,786.09	2,567.00	3,209.96	5,133.07	5,205.64	5,379.37	4,497.66	4,352.52	6,039.23
+ Net Loans	10,630.09	17,961.09	18,896.74	19,388.30	24,021.83	30,217.10	37,766.27	44,406.66	46,447.72	44,218.58	48,363.75	50,982.00
+ Total Loans	11,002.49	18,683.16	19,845.55	20,578.55	25,329.56	31,668.01	39,605.17	46,520.82	48,462.95	45,871.99	50,570.53	53,735.65
- Reserve for Losses on Loans	372.40	722.08	948.82	1,190.24	1,307.73	1,450.91	1,838.90	2,114.16	2,015.23	1,653.41	2,206.78	2,753.66
+ Long-Term Investments	462.74	817.59	1,091.11	1,577.55	1,954.57	1,927.10	1,971.16	1,973.65			527.10	
+ Net Fixed Assets	392.87	666.08	843.47	898.24	1,136.54	1,548.81	1,999.61	2,657.75	1,113.52	1,021.13	1,038.32	1,047.27
+ Other Assets	943.37	1,763.82	1,991.39	1,921.84	2,601.56	2,814.71	3,916.06	5,770.64	4,354.31	5,192.62	4,304.71	4,130.80
Total Assets	**15,396.74**	**25,843.24**	**27,465.25**	**30,281.14**	**35,489.33**	**44,087.19**	**55,408.89**	**68,027.17**	**62,961.49**	**60,788.43**	**65,404.9**	**68,282.4**
Liabilities & Shareholders' Equity												
+ Demand Deposits	2,395.47	3,403.51	894.04	1,158.24	4,980.29	5,310.24	6,393.82	8,728.51	7,635.93	7,448.91	7,145.98	7,389.08
+ Interest Bearing Deposits	7,764.05	13,380.58	14,514.25	16,385.35	17,371.28	21,272.20	29,358.63	35,729.70	31,657.54	30,407.14	33,781.03	36,238.48
+ Saving Deposits	4,470.48	6,292.02	6,222.30	7,412.52	9,412.83	12,000.54	15,343.21	18,018.60	16,465.18	15,061.80	16,227.39	18,168.47
+ Time Deposits	**3,293.57**	**7,088.57**	**8,291.95**	**8,972.83**	**7,958.45**	**9,271.66**	**14,015.42**	**17,711.10**	**15,192.36**	**15,345.34**	**17,553.64**	**18,070.02**
+ Other Deposits	204.97	249.68	2,544.33	3,087.51	339.75	466.56	553.67	553.01	583.71	512.83	604.50	561.37
+ Customer Deposits	**10,364.49**	**17,033.77**	**17,952.61**	**20,631.10**	**22,691.32**	**27,049.00**	**36,306.12**	**45,011.22**	**39,877.18**	**38,368.89**	**41,531.51**	**44,188.94**
+ ST Borrowings & Repos	28.58	27.36	25.31	23.30	336.35	1,273.42	379.46	826.48	1,198.33	697.27	755.11	1,446.87
+ Other Short-Term Liabilities	579.83	1,100.05	928.79	1,012.21	2,980.26	1,326.11	1,604.20	1,675.31	669.65	669.26	478.97	
+ Long-Term Borrowings	**2,600.97**	**4,810.44**	**5,403.70**	**4,676.93**	**3,757.36**	**9,165.80**	**9,807.11**	**12,915.43**	**11,941.65**	**12,334.87**	**12,727.86**	**11,403.55**
+ Other Long-Term Liabilities	173.08	249.47	375.50	443.12	1,545.41	595.62	697.81	870.55	1,967.20	2,289.44	1,803.89	2,029.78
Total Liabilities	**13,746.96**	**23,221.09**	**24,685.90**	**26,786.66**	**31,310.70**	**39,409.96**	**48,794.69**	**61,298.98**	**55,654.00**	**54,359.73**	**57,914.31**	**60,101.69**
+ Total Preferred Equity	54.21	75.04	61.82	74.12								
+ Minority Interest	21.83	45.70	60.14	52.07	36.80	37.89	46.06	231.64	208.11	355.48	403.04	440.88
+ Share Capital & APIC	138.06	153.25	113.29	151.38	205.30	203.21	241.02	221.48	2,246.29	1,681.64	1,779.03	1,787.65
+ Retained Earnings & Other Equity	1,435.68	2,348.16	2,544.09	3,216.91	3,936.53	4,436.13	6,327.12	6,275.06	4,853.10	4,391.58	5,308.48	5,952.10
Total Equity	**1,649.78**	**2,622.14**	**2,779.35**	**3,494.47**	**4,178.63**	**4,677.23**	**6,614.20**	**6,728.18**	**7,307.49**	**6,428.70**	**7,490.55**	**8,180.68**
Total Liabilities & Equity	**15,396.74**	**25,843.24**	**27,465.25**	**30,281.14**	**35,489.33**	**44,087.19**	**55,408.89**	**68,027.17**	**62,961.49**	**60,788.43**	**65,404.87**	**68,282.36**

Source: Bloomberg, JMMBIR

Influenced by increases in its long-term investments and net loans; the asset base of the company moved from US$65.4B in 2016 to US$68.28B in 2017. Meanwhile, total liabilities rose 3.8% during the same period amidst increase in customer deposits and time deposits. From this standpoint, shareholders' equity increased by 9.2% to close at $8.18B as at December 31, 2017.

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Table 3: Cashflow Statement

US$M	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Net Income	525.16	662.91	588.59	757.79	901.33	947.20	811.21	1,196.89	926.48	940.82	886.1
D&A and Provision for Loan Losses	454.61	1,180.85	777.14	599.17	668.59	989.76	1,151.82	874.47	982.75	1,225.19	1461.3
Other Non-Cash Adjustments	-757.57	-1,001.42	-306.14	-452.25	-743.97	-635.04	-365.86	379.11	1,027.01	497.20	-320.2
Changes in Non-Cash Capital	231.02	-110.05	-83.79	-3,567.53	-7,676.68	-1,301.30	67.47	-709.74	-326.29	402.44	-4.4
Cash From Operations	**453.23**	**732.29**	**975.81**	**-2,662.83**	**-6,850.72**	**0.63**	**1,664.64**	**1,740.72**	**2,609.96**	**3,065.64**	**2,022.83**
Cash From Investing Activities											
Disposal of Fixed Assets	42.08	14.81	85.20	264.25	95.52	100.72	173.28	239.85	106.56	181.40	-190.87
Capital Expenditures	-285.34	-393.26	-170.53	-552.45	-690.15	-630.21	-985.86	-388.57	-353.77	-355.44	-323.75
Increase in Investments		-463.73	-1,565.25	-2,002.31	-1,311.19	-1,762.18	-3,046.36	-1,513.24	-650.32	-682.00	734.45
Decrease in Investments	112.30		1,296.95	1,767.17	1,600.73	1,937.93	2,106.11	2,154.89	630.14	776.86	-1,058.19
Change in Loans	-6,323.46	-3,823.00	723.11			-6,076.43	-5,189.74	-6,522.66	-5,530.78	-3,563.60	-3,817.78
Other Investing Activities	38.28	19.17	27.11	-123.12	23.64	23.00	-28.64	-24.55	319.62	-258.23	-31.75
Cash From Investing Activities	**-6,416.15**	**-4,646.01**	**396.61**	**-646.45**	**-281.45**	**-6,407.16**	**-6,971.22**	**-6,054.30**	**-5,478.56**	**-3,901.02**	**-4,464.34**
Cash from Financing Activities											
Dividends Paid	-194.79	-229.84	-230.22	-264.65	-285.35	-324.68	-338.38	-357.84	-288.85	-275.89	-381.62
Change in Short-Term Borrowings	644.94					-1,062.47	564.87				-845.34
Increase in Long-Term Borrowings	747.95	1,257.44	659.79	1,920.57	3,910.48	1,596.88	3,018.33	5,076.89	5,879.83	5,461.62	
Decrease In Long-Term Borrowings			-341.51	-377.43	-403.94	-1,408.83	-591.90	-5,218.20	-5,665.79	-5,298.63	
Increase in Capital Stocks	14.49					919.31		1,316.47			
Decrease in Capital Stocks									-10.33		
Change in Deposits	5,390.99	3,087.04	826.53	1,059.27	4,716.90	7,081.11	6,344.59	1,438.88	3,603.75	1,680.47	2,791.03
Other Financing Activities	916.11		-1,466.17	329.34	-25.95	-149.86	185.16	1,064.99	1,313.66	-188.89	
Cash from Financing Activities	**7,519.68**	**4,114.64**	**-551.58**	**2,667.11**	**7,912.14**	**6,651.46**	**9,182.68**	**3,321.20**	**4,832.27**	**1,378.68**	**1,564.08**
Net Changes in Cash	**1,556.76**	**200.93**	**820.84**	**-642.17**	**779.97**	**244.92**	**3,876.10**	**-992.37**	**1,963.67**	**543.30**	**-778.42**

The cash generated from operating activities was lower in 2017 relative to a year ago amidst lower earnings and non-cash adjustments during the year. Notwithstanding, the company has increased its disbursement of funds for loans during 2017. Meanwhile, the company managed to access some funding through increases in deposits in a bid to improve its liquidity position.

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Table 4: Ratio Analysis

		2009	2010	2011	2012	2013	2014	2015	2016	2017
Debt	Total Debt/EBIT	6.22	4.43	10.34	9.06	15.09	13.77	13.62	10.25	10.26
	Net Debt/EBIT	1.31	0.96	6.01	4.95	6.29	7.83	7.50	5.07	5.40
	Common Equity/Total Assets	11.12	11.67	10.52	11.85	9.55	11.28	9.99	10.84	11.34
	Long-Term Debt/Equity	133.84	89.92	195.97	148.27	191.96	163.42	191.87	167.33	139.40
	Long-Term Debt/Capital	57.07	45.42	60.63	58.37	63.09	58.40	63.38	59.76	54.22
	Long-Term Debt/Total Assets	15.45	10.59	20.79	17.70	18.99	18.97	20.29	19.16	16.70
	Total Debt/Equity	134.50	97.97	223.19	154.01	204.24	179.82	202.72	180.00	157.08
	Total Debt/Capital	57.36	49.49	69.06	60.63	67.13	64.26	66.97	64.29	61.10
	Total Debt/Total Assets	15.52	11.54	23.68	18.38	20.20	20.87	21.44	20.61	18.82
	Net Debt/Equity	-27.63	21.39	130.83	84.71	88.19	102.27	111.59	88.97	82.72
	Net Debt/Capital	-38.19	17.62	56.68	45.86	46.86	50.56	52.74	47.08	45.27
Liquidity	CFO/Total Liabilities	3.81	-8.40	-16.55	0.001	2.64	2.62	4.11	5.29	3.37
	CFO/CapEx	5.72	-4.82	-9.93	0.001	1.69	4.48	7.38	8.62	6.25
	Interest Expense/Free Cash Flow	1.53 -	0.26 -	0.15 -	2.56	2.46	1.17	0.66	0.73	1.24
	Interest Expense/Cash Balance	0.34	0.30	0.28	0.40	0.28	0.34	0.33	0.37	0.41
Profitability	Return on Common Equity	16.79	19.37	19.64	16.52	12.57	16.26	13.94	14.13	11.78
	Return on Assets	2.03	2.21	2.17	1.86	1.32	1.70	1.47	1.47	1.31
	Return on Capital	7.23	8.89	7.42	5.79	4.44	5.52	4.73	4.74	4.38
	Operating Margin	26.69	31.63	30.25	26.34	22.02	26.29	26.62	26.96	23.84
	Pretax Margin	29.98	34.97	33.16	28.83	24.51	35.99	28.36	27.10	25.46
	Net Income Margin	21.73	25.66	25.71	22.56	19.05	27.67	22.08	19.57	16.67

Source: Bloomberg, JMMBIR

The company showed a slight improvement in its leverage position in 2017 relative to 2016. Following from the deterioration in cash generated from operating activities, there was some weakening in its liquidity position during 2017. On a similar note, the profitability of the company was lowered during financial year 2017 on the heels of enhancement in revenues amidst some challenges in the wider economy and increases in interest costs and other expenses.

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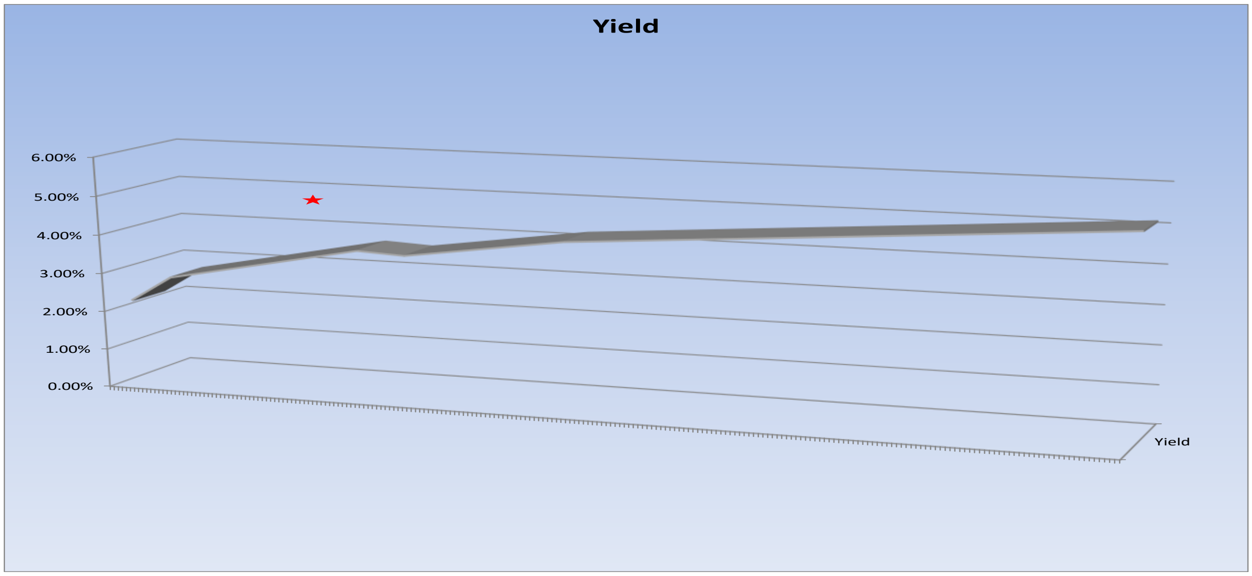
Yield Analysis on comparable bonds

Graph 5: Yield Curve for comparable bonds



Source: Bloomberg, JMMBIR

From a yield standpoint, the BCOLO 5.95% due to mature in 2021 at a yield 4.03% is undervalued relative the other instruments of similar credit quality. Investors may have been incentivized to liquidate their holdings given lower profitability. The current upward movements in global interest rates will continue to be a challenge for existing bondholders in terms of mark to market movements.

Recommendation:

The Colombian economy is expected to benefit from increases in private investments on the heels of the tax reform incentives, exchange rate and interest rates movements. Financial and social services contributed significantly to the growth in 2017. The current trend is expected to continue and BCOLO should benefit from this. On the other hand, May 2018 elections could provide some level of political uncertainty which could potentially affect the rate of investments over the near term. The BCOLO's bonds have seen some downward pressure in recent times and global interest rates continue their upward trajectory. With this said, more attractive entry points will become available over the near to medium term for investors looking to buy and hold. From these standpoints, this investment is recommended as a **HOLD** this time.

Source: http://www.jamstockex.com, JMMB Investment & Research, Bloomberg, Various Company Financial Statements, Standard & Poor's

APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT—As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

PLEASE NOTE THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

UNDERWEIGHT—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

SELL—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

HOLD/MARKETWEIGHT—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

OVERWEIGHT/BUY—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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Bancolombia 5.95% Due 2021

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