Corficolombiana | CasadeBolsa la comisionista de bolsa de Grupo Aval

Equity Research
SPECIAL REPORT

COVID-19 and Oil
Where do we draw the line? Right here – Part I

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COVID-19 and Oil Where do we draw the line? Right here

Part I

1. Overview
2. Oil and Gas + Construction

Part II

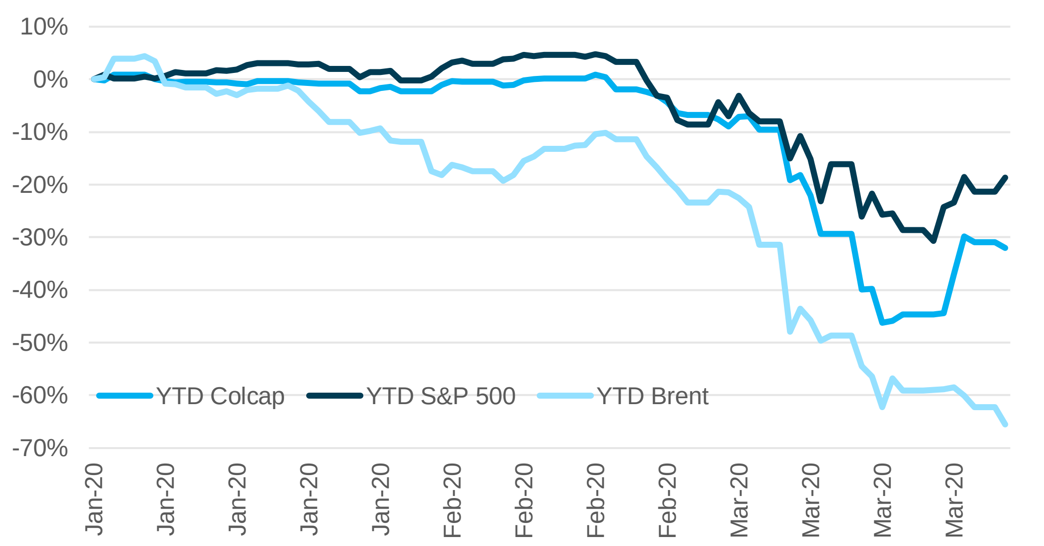
1. Consumer, Financial services, Utilities (Energy) and Other (Real Sector)
2. Conclusions

COVID-19 and Oil Where do we draw the line? Right here

The adverse effects of COVID-19 on global growth has resulted in worldwide stock market corrections and an undervalued equity market in Colombia.

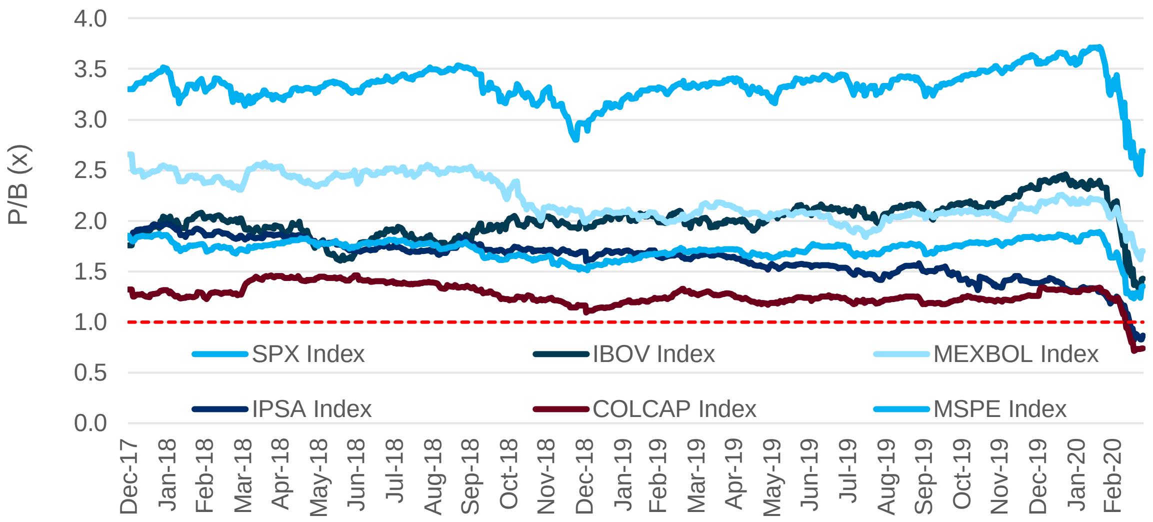
- The steep year-to-date decline experienced by the Colcap (Colombia´s equity capitalization index), is in line with price corrections in the S&P 500 and other stock market indices.
- Prior to the recent price correction, Colombia's equity market was somewhat undervalued, so the decline in recent weeks has made prices more attractive, which lead to the expectation that several of the stocks will recover.
- Since its launch in 2008, the Colcap Index has had a holding period return of 12.4% (-30.6% in real terms), equivalent to 1.0% CAGR (-2.9% in real terms and -4.5% in dollars). In the meantime, Colombia's GDP holding period return is 71.3%, and as we will show, this large gap is also observed at the company level.

Colcap, S&P 500 and Brent



Source: Bloomberg and Corficolombiana.

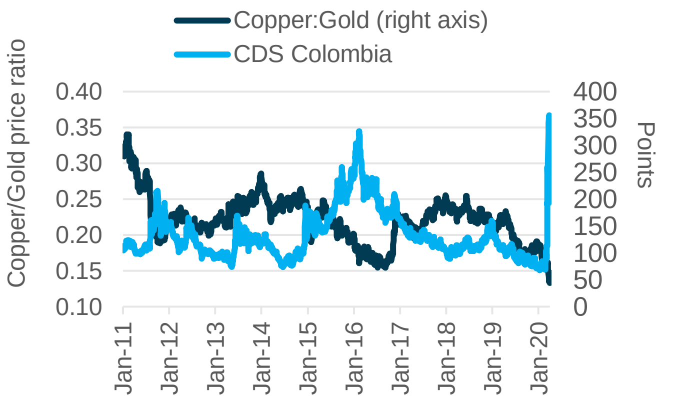
Price to Book value for international equity indexes



Source: Bloomberg and Corficolombiana.

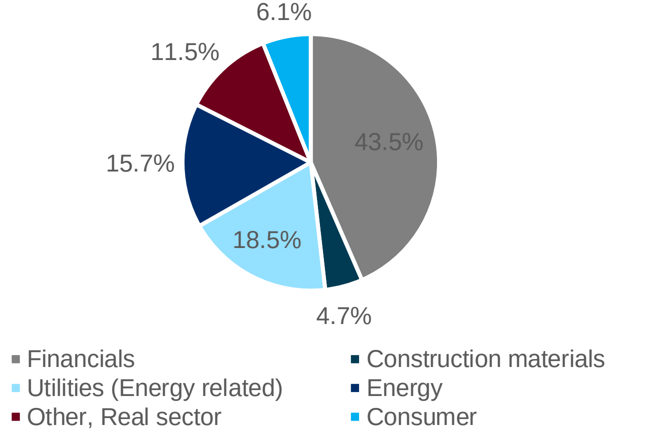
Colombian equities' earnings seem more vulnerable to lower oil prices than to COVID-19, with several natural hedging conditions in place.

Copper: Gold ratio and Colombian 5yr CDS



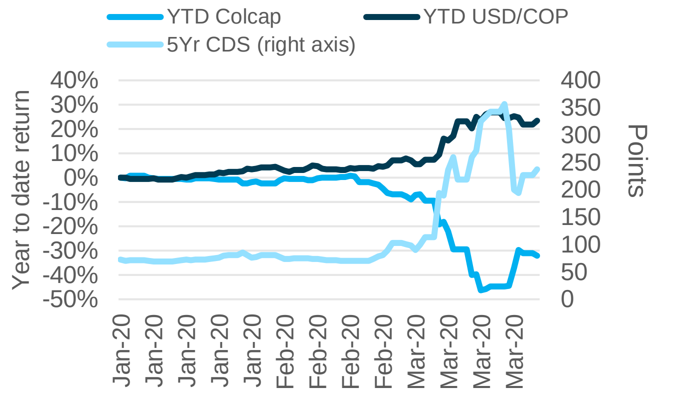
Source: Bloomberg and Corficolombiana.

Colcap Index sector weights



Source: BVC and Corficolombiana.

Colcap, 5yr CDS and FX



Source: Bloomberg and Corficolombiana.

- Given the relative character of stock prices, we base our expectation of recovery in several intrinsic asset valuation arguments, including financial leverage, FX vulnerabilities, expense and fee structures, the sector's association with the country's GDP, and other equity valuation approaches.
- At first sight, industries such as restaurants, hotels, leisure and transportation are more vulnerable to COVID-19, as the cautionary measures affect household consumption decisions. The share of these industries in the Colcap Index is not material (less than 1%).
- Meanwhile, the Energy sector (Oil and Gas) represents around 15.7% of the current capitalization index, much more than the 2.6% share present on the S&P 500 index.
- Industrials and Commerce are also expected to suffer a reduced effect from COVID-19, but Industrials' presence in the Colcap is indirect and reduced with the 4.7% share of construction materials, while Commerce is represented by the consumer sector related companies (staples and discretionary), which are actually benefiting from the crisis.

Ecopetrol

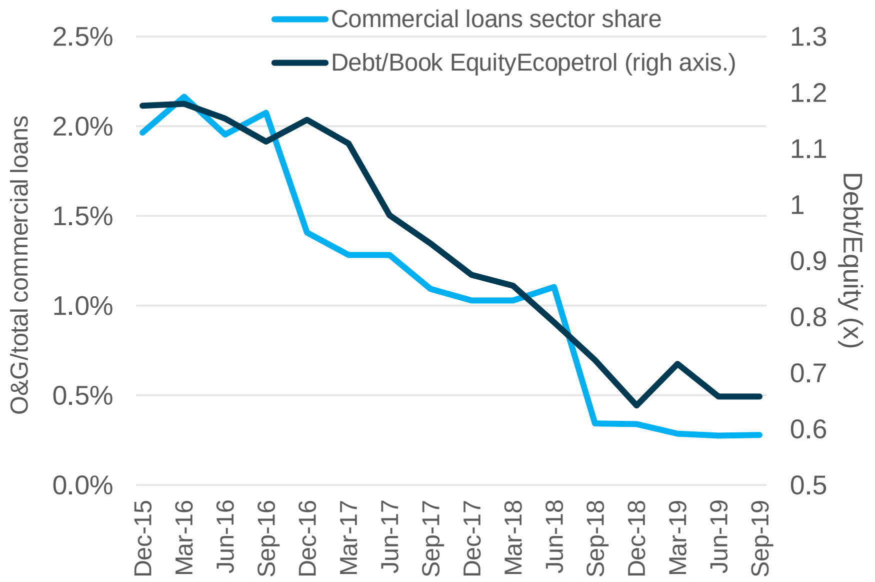
Better suited to cruise the terrible weather:

Ecopetrol is a vertically integrated oil and gas company with presence primarily in Colombia and with activities in Peru, Brazil, Mexico and the U.S. Recent year's operational and financial strengthening will help the company sort today's troubled markets, with the final outcome depending on how long the spot price levels remain depressed.

Trading Statistics	
March close (COP).	1,900
Last (COP)	1,840
2019 return (%)	25.3.
YTD return (%)	-42.7
Maximum	5,850
Minimum	881
Trailing P/E (x)	6.63.
Trailing P/B (x)	1.40
Dividend yield (%)	9.8.
EBITDA 2019 (USD MM)	9,478

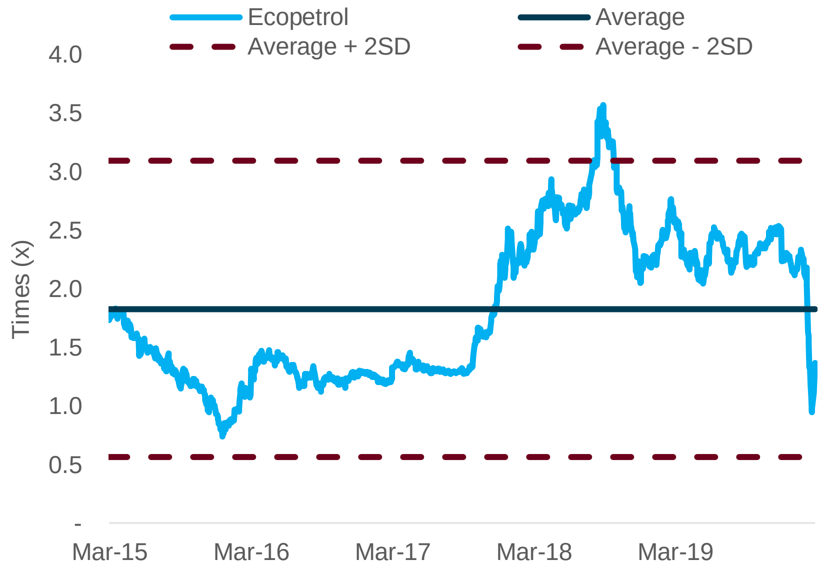
Source; BVC, Bloomberg and Corficolombiana

Banking system exposition to O&G and Ecopetrol's leverage



Source: Superfinanciera, Ecopetrol IR and Corficolombiana.

Ecopetrol's historic Price/Book



Source: Bloomberg, Capital IQ and Corficolombiana.

Ecopetrol - Analysis

	Sector Specific	Financials	Trading Overview/ Valuation *
Exposure / Risk	**Sector specific risk** Oil oversupply during a period of an economic standstill makes it difficult to foresee a correction in prices, threatening the preservation of a great deal of companies and related businesses. The company needs Brent oil prices above USD 29.1/bl to obtain positive earnings.	**Fixed and variable costs:** Approximately 82.7% of Ecopetrol's costs of sales are variable, most costs and a fair deal of capex are Colombian peso denominated.	**Stock appreciation:** Between mid 2015 and the end of 2017 the stock registered prices similar to those being registered nowadays, but last time, the drop in prices took a year, this time it has been less than a month, which outlines a much more volatile market.
Growth	**Association with GDP:** On top of the strong relationship with the Oil & Gas GDP, Ecopetrol is the largest single contributor to the country's capital investment.	**Revenue sales:** Around 56% of sales are exports, and most of sales are USD denominated. The relation between FX and oil prices usually favors Ecopetrol's results in COP.	**P/E:** Ecopetrol's current –diminished- P/E of 6.63x is near the median of its pear group, showing that the whole industry has been negatively affected by the current shock and an expectation of deteriorating results.
Structure / Framework	**Industry participation on commercial bank loans:** The share of the mining and energy industry in the total commercial loan portfolio of Colombia is only 1.3%. If only oil and gas extraction is considered, that share drops down to 0.3%.	**Financial leverage:** 2019's net debt/EBITDA was 1.0x, and 88.3% of total debt was USD denominated. FX exposure is high, but manageable given the denomination of revenue.	**P/B:** The 1.4x P/B level, is well below last year's average (2.3x) is considerably higher than the 0.6x median value of its peers, displaying the company's relative strength, and a large space to fall relative to the peer group.
Potential Recovery	**Government measures :** Given the 88.49% stake of the government in the company, we take the reduction of 24% in 2020's capex, which is now expected at around USD 3,800 MM as a government measure, which should enable the continuity of the business, despite the ongoing industry crisis.	**Financial strength:** The combined effect of FX and oil prices on earnings (in COP), low proportion of fixed costs in cost of sales and low leverage, complement the huge improvement accomplished by the company in terms of costs, capex, and secondary recovery.	**Valuation:** **For a range in Brent spot prices between USD 26 and 36/bl, the stock price range as a function of 1P reserves is between COP 1,174 and 1,894/share; while the 2-stage dividend discount model results in a lower bound of around COP 2,100.**

**Peers: Cenovus, Imperial. Suncor, Conoco Phillips, Occidental and Petrobras*

Canacol Energy

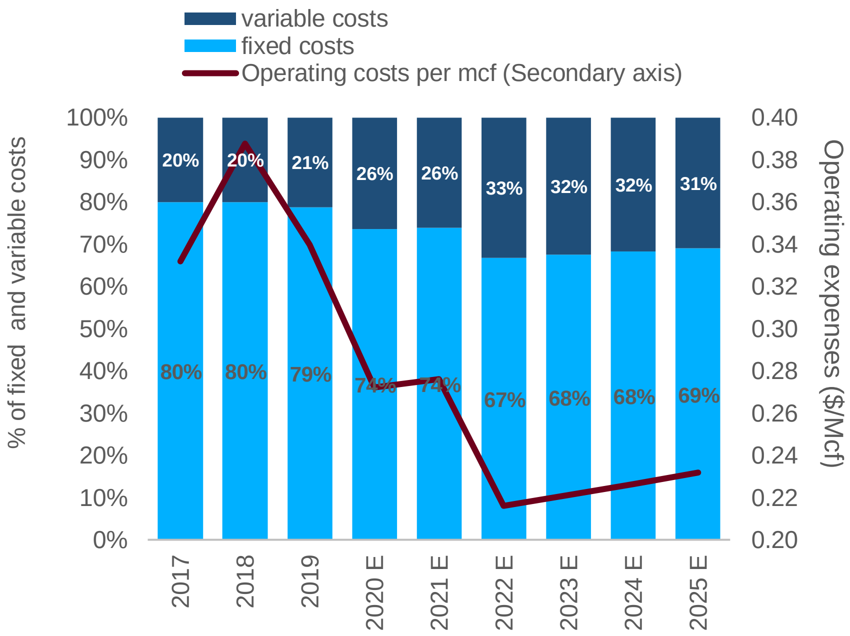
Natural gas pure-play stock :

Conventional natural gas producer (*Upstream*) concentrated in Colombia. The company's main gas fields of operation are located in the lower and middle Magdalena basin. Canacol has shown an impressive gas exploration performance. Four fifths of its revenue come from dollarized long-term contracts.

Trading Statistics	
March close (COP).	10,400
Last (COP)	10,200
2019 return (%)	24.1
YTD return (%)	-13.0
Maximum	14,740
Minimum	468
Trailing P/E (x)	14.2
Trailing P/B (x)	2.0
Dividend yield (%)	6.6
EBITDA 2019 (USD MM)	167.5

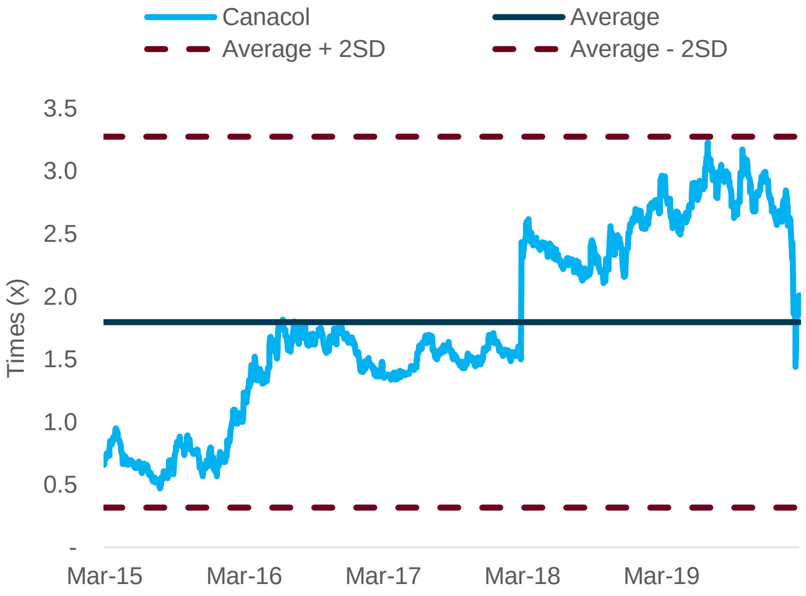
Source; BVC, Bloomberg and Corficolombiana

Operating expenses ($/Mcf)



Sources: Capital IQ, Bloomberg and Corficolombiana.

Canacol's historic Price/Book



Sources: Bloomberg, Capital IQ and Corficolombiana

Canacol Energy - Analysis

CANACOL ENERGY LTD.

	Sector Specific	Financials	Trading Overview/ Valuation *
Exposure / Risk	**Sector specific risk** Lower world-wide demand for oil and oversupply from Russia and Saudi Arabia has driven oil prices to their minimum lows not seen since 2003. We expect further volatility on both oil and gas prices in the short term. In addition, we see a risk on sales in the short term due to the reduction of energy demand.	**Fixed and variable costs:** Around 80% of total operating costs are fixed, therefore, as production ramps up to 205 mmcfd in 2020, we anticipate a 9% y/y increase on net operating profit. Furthermore, since expenses are in Colombian pesos while revenue is in US dollars, the company is benefitting with the current devaluation of the Colombian peso.	**Stock appreciation:** The momentum gained by the stock in October 2019, as the market priced in Canacol's production growth, has been offset in the last couple of weeks. Canacol's current stock level (COP 10,200) is at a number which had not been seen since May of last year.
Growth	**Association with GDP:** Canacol exhibits a strong but lagging relationship with the Oil & Gas GDP. We expect this relationship to be less evident as the company focuses mainly on gas production and disposes of its oil assets.	**Revenue sales:** 80% of sales come from long-term fixed-price take-or-pay sales contracts with no exposure to international commodity prices. Spot sales, which represent 20% of total revenue, will most likely exhibit volatility on 2020.	**P/E:** Canacol's current P/E of 14.2x is well above its peers as they experienced a major drop in their market value in the last couple of weeks. However, we believe that Canacol's inherent risks and growth prospects are not correctly priced in, at current levels.
Structure / Framework	**Industry participation on commercial bank loans:** After the sudden drop in oil prices in 2014, Colombian Banks reduced significantly their exposure to the Oil & Gas industry, from 2% in 2015 to the current 0.3% level.	**Financial leverage:** In 2018, Canacol executed the conversion of its bank debt into senior unsecured bonds. The company successfully postponed the maturity of its debt obligations to December 2025, while significantly reducing its financial costs.	**P/B:** Company's current trading P/B multiple of 2.0x is slightly above its historical multiple and outperforming its Oil &Gas peers as the market has seen a major sell off, of companies holding oil assets. *Average comps Price to book = 0.2x*
Potential Recovery	**Government measures :** Contracts under the take-or-pay modality can be modified by mutual agreement (buyer and seller). This applies to both prices and quantities established in the contracts. This measure is transitory given the expected drop in gas demand.	**Financial strength:** Low production costs with fixed price (USD) long term contract sales. As the business continues to experience strong sales, free cash flow generation will support the company's' current share buyback and dividend distribution programs.	**Valuation:** **Our discounted cash flow model yields a blended value of CAD 6.25 – 6.50 per share based on current production plans. Using the dividend discount model approach, Canacol's current share price would be overvalued by 19.6%.**

**Source: Dorchester, Enauta, Freehold, Paramount, Torc, WT and Whiting*

Cementos Argos

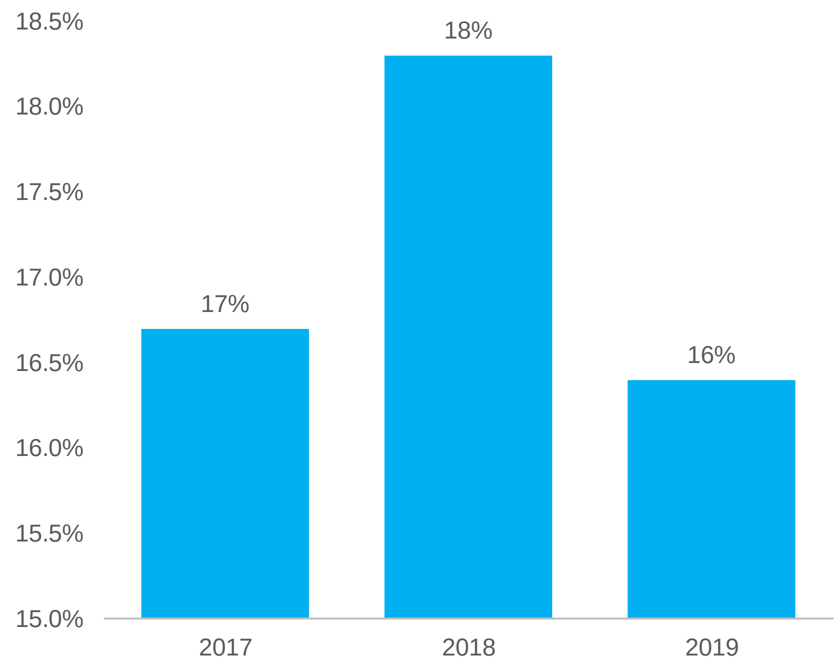
Powerful diversification:

Cement company with presence in USA, Colombia, The Caribbean & Central America, with location near growing demand centers in USA and national coverage in Colombia (~ 40% market share). Cemargos plays a leading role in construction materials supply in the US, a country that has recently announced a large infrastructure budget.

Trading Statistics	
March close (COP).	**4,090**
Last (COP)	**3,900**
2019 return (%)	**4.9**
YTD return (%)	**-44.0**
Maximum	**13,400**
Minimum	**2,420**
Trailing P/E (x)	**44.7x**
Trailing P/B (x)	**0.7x**
Dividend yield (%)	**6.3**
EBITDA 2019 (COP Bn)	**1,757**

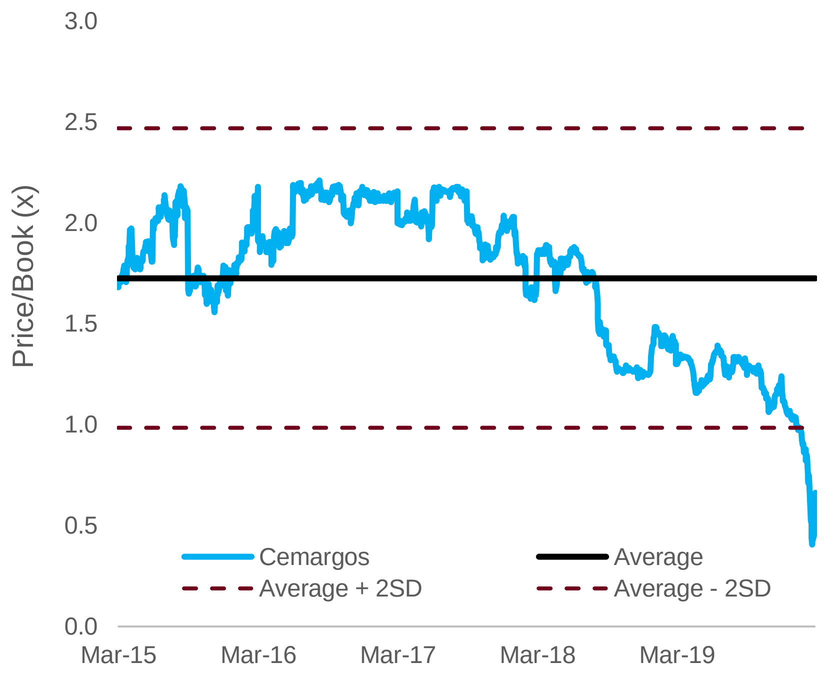
Source: BVC, Bloomberg and Corficolombiana

Cementos Argos´s EBITDA Margin



Source: Cementos Argos.

Cementos Argos's historic Price/Book



Source: Bloomberg, Capital IQ and Corficolombiana.

Cementos Argos - Analysis

	Sector Specific	Financials	Trading Overview / Valuation *
Exposure / Risk	**Sector specific risk** The construction materials industry is strongly related with construction sector (infrastructure, residential and non – residential). This sector could be impacted in Colombia, USA, The Caribbean & Central America by the COVID-19 current situation.	**Fixed and variable costs:** Energy represents nearly 25% of production costs. The reduction in operations of some plants may result in variable costs reduction related with production of cement (mainly Clinker) and a drop in logistic costs, among others.	**Stock appreciation:** Stock price is lower than the levels registered in 2017 when (in Colombia) demand presented a weak dynamic and cement prices dropped due to imported cement volumes from Turkey.
Growth	**Association with GDP:** Despite belonging to the construction materials industry, we follow the Construction GDP, with a moderate association (sales and GDP) in Colombia given the share of sales in the USA.	**Revenue sales:** ~ 56% USA ~ 25% Colombia ~ 25% CCA	**P/E:** Current: 45x, Average: 78x Peer´s Average: 17x Historically, Cementos Argos has had a greater P/E than its peers, partly due to a higher payout that usually includes reserves.
Structure / Framework	**Industry participation on commercial bank loans:** Construction sector has a relatively stable participation on commercial bank loans (~ 15%). Nevertheless, since 2017 portfolio quality has deteriorated constantly because of construction deceleration, including some infrastructure and building projects.	**Financial leverage:** ~ USD 300 MM in short term debt (15% of total debt) with Banks. 48% of total debt in USD. 2019 Net Debt/ EBITDA: 4.1x 2019 Debt / Equity: 87% Divestment plan, related with sales of non-core assets in USA, aiming to lower their leverage ratio, could slow down.	**P/B:** Current: 0.7x, Average: 1.7x Current Price/Book ratio is low. We think that the company will have a transitory shock, but growth rate, payout and ROE should improve gradually in the mid – term.
Potential Recovery	**Government measures :** Until now we don´t see any specific measures from the Colombian Government focused on this sector in relation to COVID-19.	**Financial strength:** USA: Nearly 50% of EBITDA and 56% of revenue sales. Financial results will be benefitted by the Colombian peso devaluation. According to the company, until March 24th operations of Cementos Argos in the USA had been normal, considering construction is an essential activity.	**Valuation:** **Using a three phased dividend discount model, the stock price should be at COP 3,545, which implies a "floor" for the stock price. Even though the company will have a slowdown in the next periods, future reactivation of construction sector should imply a recovery in volumes and revenue sales, but it will depend in part on the recovery of the real estate.**

**Source: Cementos Pacasmayo, Cemex, Unacem, Chihuahua, Elementia, Lafarge and Heidelberg.*

Cemex Latam Holdings

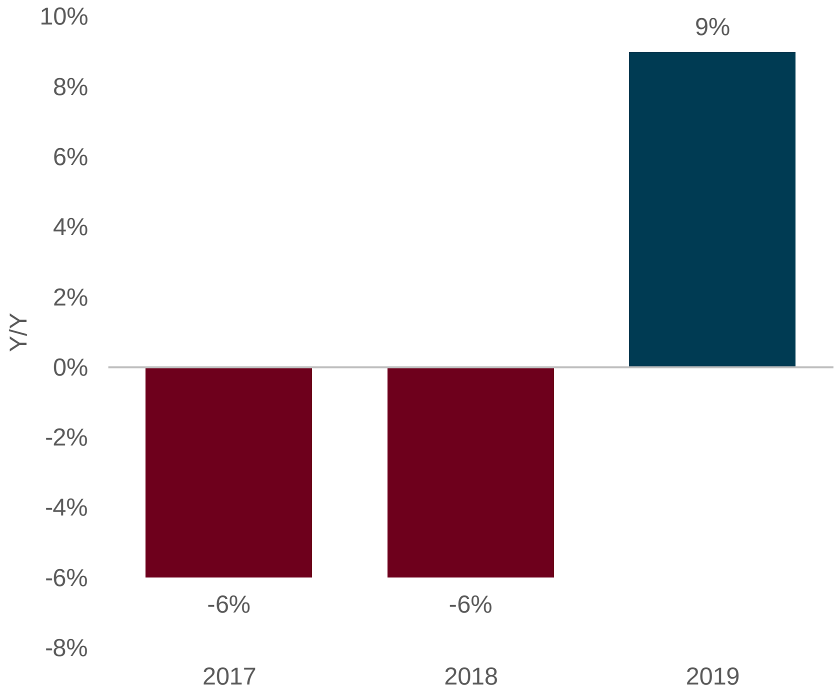
Latam region limits CLH's growth possibilities:

Cement company with presence in Colombia, Panamá, Costa Rica, primarily; with nearly 30% market share in Colombia, 40% in Panama and 50% in Costa Rica. CEMEX SAB is the holding company of CLH.

Trading Statistics	
March close (COP)	1,490
Last (COP)	1,360
2019 return (%)	19.1
YTD return (%)	-66.2
Maximum	19,820
Minimum	1,490
Trailing P/E (x)	47.9
Trailing P/B (x)	0.1
Dividend yield (%)	No dividend
EBITDA 2019 (USD MM)	199

Source: BVC, Bloomberg and Corficolombiana

CLH´s Colombia Cement Volumes



Source: Cemex Latam Holdings.

CLH's historic Price/Book

Source: Bloomberg, Capital IQ and Corficolombiana.

Cemex Latam Holdings - Analysis

	Sector Specific	Financials	Trading Overview / Valuation *
Exposure / Risk	**Sector specific risk** The cement sector is strongly related with construction sector (infrastructure, residential and non – residential). This sector could be impacted in Colombia and Central America by the COVID-19 current situation.	**Fixed and variable costs:** Energy can represent nearly 33% of production costs. The reduction in operations of some plants may represent variable costs reduction related with production of cement (mainly Clinker) and logistic costs, among others.	**Stock appreciation:** Current stock price is below 2017 levels, when cement prices dropped due to imported cement volumes from Turkey, and below 2018's, when United States and Colombian authorities made additional investigations due to legal problems with The Maceo Plant.
Growth	**Association with GDP:** Despite belonging to the construction materials industry, we follow the Construction GDP. The similarities in the region (developing Latam countries), results in a notable association between the company's revenue and Colombia's construction GDP.	**Revenue sales:** ~ 50% Colombia ~ 18% Panamá ~ 10% ~ 22% Rest of CLH Defending EBITDA margins in US dollars can lead to a loss in market share.	**P/E:** Current: 48x Average: 24x Peer´s Average: 15x High volatility of exchange rate, fast stock price decreases and weak net incomes affected trailing P/E.
Structure / Framework	**Industry participation on commercial bank loans:** Construction participation is stable at around 15%. Nevertheless, since 2017 portfolio quality has deteriorated constantly because of construction deceleration, including some infrastructure and building projects.	**Financial leverage:** 69% of debt with fixed interest rate. Net Debt/ EBITDA: 3.8x Debt / Equity: 53% CLH do not have material debt maturities until December 2022 and February 2023 (USD 84 MM and USD 503 MM) respectively.	**P/B:** Current: 0.1x, Average: 1.2x Price/Book ratio is extremely low relative to its average. Even though 2019 ROE was the lowest in history (0.3%), we think that after transitory shock, this metric should improve in some way.
Potential Recovery	**Government measures :** Until now we don´t see any specific measures from the Colombian Government focused on this sector in relation to COVID-19.	**Financial strength:** Nearly 96% of its financial debt lenders are companies' subsidiaries of CEMEX S.A.B. However, CLH has part of its revenues in COP and debt in USD.	**Valuation:** **Current stock prices would be fair if a decline in volumes sold is greater than 20% in 2020 and 2021 were to take place. Despite current slowdown, future construction reactivation should result in a recovery in volumes sold, but this depends largely on a recovery of the real estate sector.**

**Source: Cementos Pacasmayo, Cemex, Unacem, Chihuahua, Elementia.*

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EL(LOS) ANALISTA(S) QUE PARTICIPÓ(ARON) EN LA ELABORACIÓN DE ESTE INFORME CERTIFICA(N) QUE LAS OPINIONES EXPRESADAS REFLEJAN SU OPINIÓN PERSONAL Y SE HACEN CON BASE EN UN ANÁLISIS TÉCNICO Y FUNDAMENTAL DE LA INFORMACIÓN RECOPILADA, Y SE ENCUENTRA(N) LIBRE DE INFLUENCIAS EXTERNAS. EL(LOS) ANALISTA(S) TAMBIÉN CERTIFICA(N) QUE NINGUNA PARTE DE SU COMPENSACIÓN ES, HA SIDO O SERÁ DIRECTA O INDIRECTAMENTE RELACIONADA CON UNA RECOMENDACIÓN U OPINIÓN ESPECÍFICA PRESENTADA EN ESTE INFORME.

INFORMACIÓN DE INTERÉS

Algún o algunos miembros del equipo que participó en la realización de este informe posee(n) inversiones en alguno de los emisores sobre los que está efectuando el análisis presentado en este informe, en consecuencia, el posible conflicto de interés que podría presentarse se administrará conforme las disposiciones contenidas en el Código de Ética aplicable.

CORFICOLOMBIANA Y CASA DE BOLSA O ALGUNA DE SUS FILIALES HA TENIDO, TIENE O POSIBLEMENTE TENDRÁ INVERSIONES EN ACTIVOS EMITIDOS POR ALGUNO DE LOS EMISORES MENCIONADOS EN ESTE INFORME, SU MATRIZ O SUS FILIALES, DE IGUAL FORMA, ES POSIBLE QUE SUS FUNCIONARIOS HAYAN PARTICIPADO, PARTICIPEN O PARTICIPARÁN EN LA JUNTA DIRECTIVA DE TALES EMISORES.

Las acciones de Corficolombiana se encuentran inscritas en el RNVE y cotizan en la Bolsa de Valores de Colombia, por lo tanto, algunos de los emisores a los que se hace referencia en este informe han, son o podrían ser accionistas de Corficolombiana.

Corficolombiana hace parte del programa de creadores de mercado del Ministerio de Hacienda y Crédito Público, razón por la cual mantiene inversiones en títulos de deuda pública, de igual forma, Casa de Bolsa mantiene este tipo de inversiones dentro de su portafolio.

ALGUNO DE LOS EMISORES MENCIONADOS EN ESTE INFORME, SU MATRIZ O ALGUNA DE SUS FILIALES HAN SIDO, SON O POSIBLEMENTE SERÁN CLIENTES DE CORFICOLOMBIANA, CASA DE BOLSA, O ALGUNA DE SUS FILIALES.

Corficolombiana y Casa de Bolsa son empresas controladas directa o indirectamente por Grupo Aval Acciones y Valores S.A.