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Grupo Sura Represents An Attractive Contrarian Bet On Latin America

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by: Ohio Capital Ideas

Summary

- Latin American equities have been weak performers for a number of years now. COVID-19 has further pressured shares across the region.
- As the cleanest way to invest in the Grupo Empresarial Antioqueño business group, Grupo Sura offers investors a substantial amount of resiliency and stability.
- Shares of Sura offer an interesting contrarian opportunity that combine an excellent valuation, both at the holding company and of the underlying assets, with high quality assets.

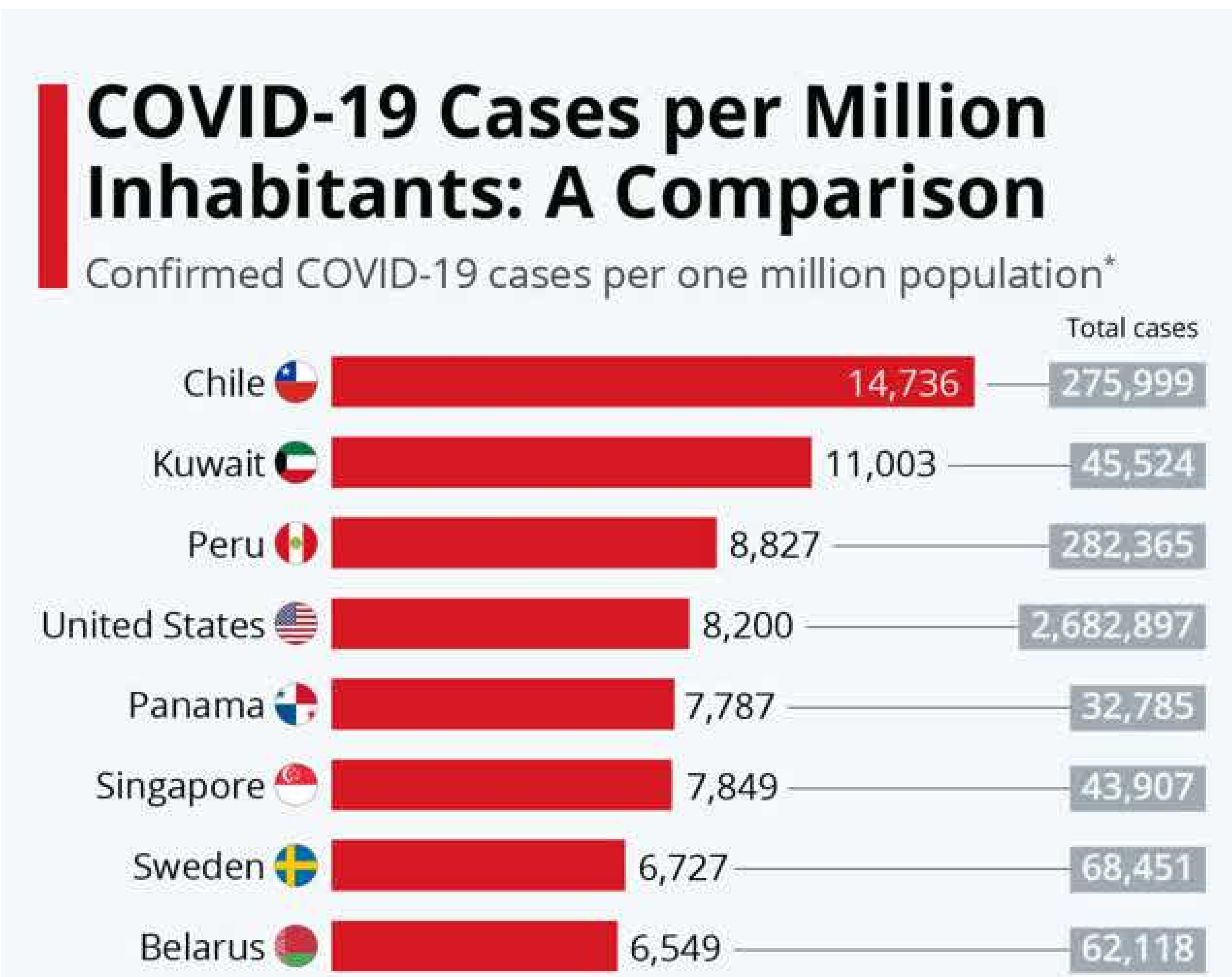
The thesis on Grupo Sura (OTCPK:GIVSY) is fairly straightforward: Grupo Sura common shares represent ownership in a terrific collection of assets under the ownership of a group with a long-term orientation and at an extremely attractive valuation. Indeed, not only is the holding company trading at an attractive discount to its underlying assets but even after accounting for the substantial disruption of COVID-19, each of the group's individual holdings trade for attractive valuations and is set to continue compounding earnings at impressive rates for the foreseeable future.

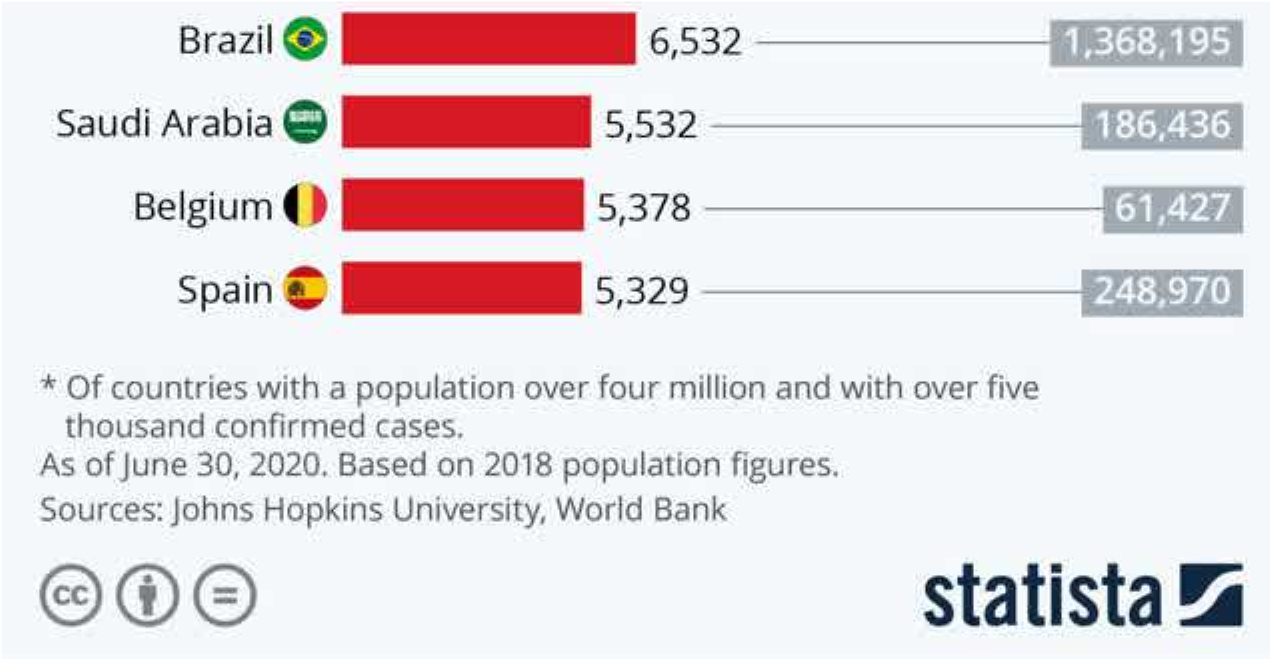
The bear case on Grupo Sura, Colombia, and Latin America is not difficult to construct. Indeed, the macro environment is the biggest reason why opportunity exists today. It should also not be overlooked. Given the severity of the economic shock currently, I start by reviewing that shock before discussing the company itself in greater depth.

Grupo Sura headquarters. Source: Company.

The New Epicenter

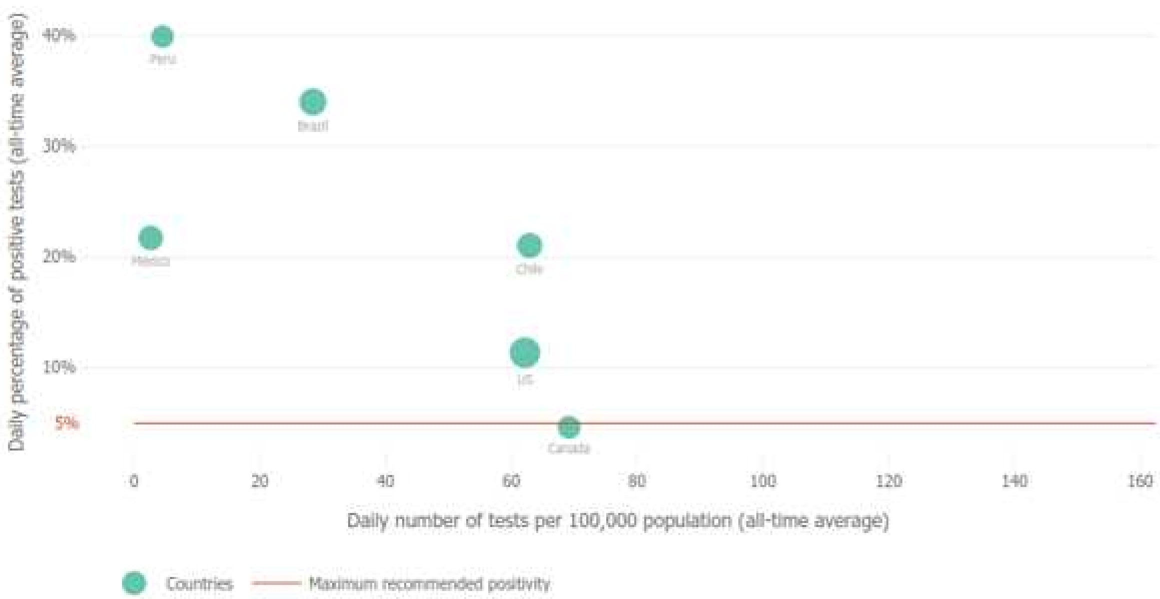
Looking back, when the history of the COVID-19 pandemic is finally written, it may well be the case that Latin America was hit harder than any other region in the world. According to data from Johns Hopkins University and compiled by Statista, Chile has had more confirmed COVID-19 cases per million than any other country, with Peru, Panama, and Brazil also ranking near the highest in the world.





Source: Statista

To be fair, the level of testing within Latin America has varied considerably, so simply comparing confirmed cases per capita between countries in the region can give a false impression of the underlying spread of the virus. Chile, for instance, has done substantially more testing than Brazil or Peru and is almost certainly in far better shape than those countries.



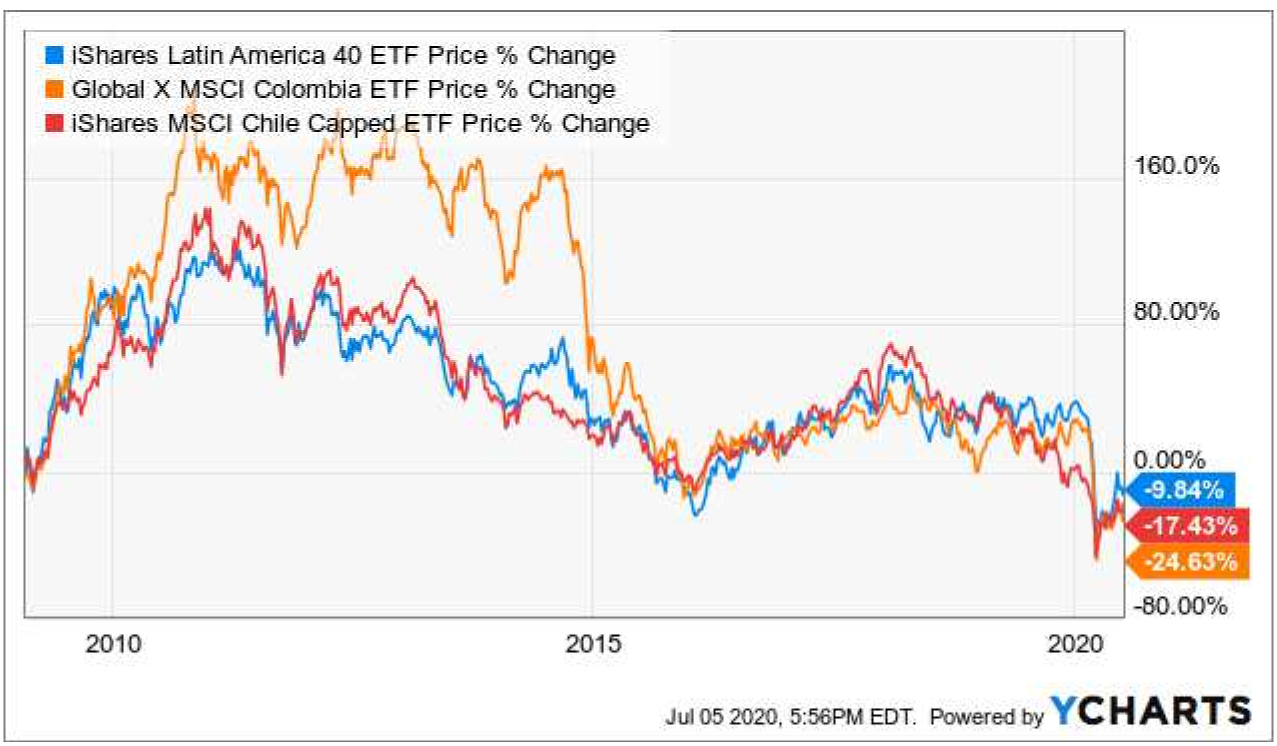
Source: Johns Hopkins University

However, there is little doubt that the region has been hit hard in aggregate and the economic impact has been extreme as well. This has been the case for a variety of factors. Latin American countries tend to be highly urbanized. In Chile, 88% of the country's population lives in urban areas, while the figure is 87% for Brazil, 81% for both Colombia and Mexico, and 78% for Peru. Western Europe and North America are the other two regions of the world that have rates of urbanization as high as Latin America, but those regions tend to have health care systems in a much better position to contain the spread of the virus. Income inequality and large informal sectors of the economy have also been in a hindrance in containing the spread and treating those infected. Finally, poor governance, in general, has also afflicted some countries in the region, none more so than Latin America's two largest economies of Brazil and Mexico.

Standard and Poor's now sees a permanent reduction in GDP in the region of about 6% and for 2020 S&P sees a GDP contraction of about 7% in Brazil and Chile, 5% in Colombia, and 8.5% in Mexico.

A Multi-Year Latin Bear Market

It may not be hard to construct a bear case for Latin America as a whole. But, it is also a mistake to believe that GDP growth and local stock markets should be perfectly correlated and that a bull case does not also exist. That contrarian bull case begins with valuation. Some indexes and individual equities in the region are now trading at levels near financial crisis lows. Below, the iShares Latin American 40 ETF (ILF) (which is about 60% invested in Brazil and about 20% invested in Mexico) is shown since 2009, along with ETFs that track the Colombian (GXG) and Chilean (ECH) markets.



Data by YCharts

Valuations, in the aggregate, look attractive as well, despite a bounce off the bottom in some Latin American markets over the past several weeks.

United States	28.3
Developed Europe	16.2
Japan	19.1
Emerging Markets	13.7
Mexico	14.7
Brazil	14.2
Colombia	9.7
Peru	11.1
Chile	11.1

Cyclically adjusted price to earnings ratios as of May 31, 2020. Source: Star Capital.

In a very thoughtful recent blog post, Jean van de Walle linked the struggles of emerging markets with the so called "death of value."

> It is no coincidence that emerging market stocks and value have both performed very poorly over the past decade. To a considerable degree, they are tied at the hip, both representing exposure to more risky and more cyclical segments of the market (though this has been somewhat mitigated in recent years with the rise of Chinese tech stocks)...EM stocks and value both perform relatively well in decades when the S&P 500 does poorly. Both value and EM are "risk-on" trades, that do poorly in those decades of "American Exceptionalism" when investors are enamored with American growth stocks. We are coming out of such a decade, when the FAANGs, turboed by record-low interest rates, have dominated the markets.

Might an inflection point be around the corner where growth no longer dominates and international equities (and emerging markets in particular) again have their moment in the sun? Maybe. I do not know when precisely that might be, but Latin America, in particular, does have some potential tailwinds. A movement of manufacturing capacity out of China could be a boon to the region (Mexico in particular) and a new move upward in commodity prices may not be as far fetched as it sounds.

Periods like today, where economic volatility and financial stresses abound, demonstrate investing in companies with financial strength and conservative cultures are as important as ever. One such company in the region, which not only exhibits both of these qualities but does so in combination with a secular growth story and an attractive valuation is

Grupo Sura.

Grupo Empresarial Antioqueño

Grupo Sura is a Medellin, Colombia based company and part of the business group Grupo Empresarial Antioqueño (GEA), which translates to Antioquian Business Group. (Antioquia is the department in which Medellin is located.) GEA is not a formal business, it is an informal entity that was created through the cross-ownership of the leading companies of the city and includes Grupo Sura, one of the leading insurers in Latin America, Bancolombia (CIB), Grupo Nutresa (OTCPK:GCHOY), and Grupo Argos.

GEA was formed in the 1970s to prevent hostile takeovers of local businesses by outsiders and helped businesses survive an extremely dark period in the 1980s and 1990s for Medellin. The stability and lower cost of capital for the business group also helped to propel it to international markets as well.

In many ways, the GEA business group has the aspects of family holding companies that make them appealing: the executives running these companies have an immense sense of historical and regional pride of leading them, have skin in the game and take a conservative approach to risk. Years of chaotic economic conditions and past local violence have instilled a long-term perspective and a degree of cultural resilience as well.

One can gain exposure to the group through different companies, but Grupo Sura gives the broadest exposure, with holdings in all three of the other main entities. Gonzalo Alberto Pérez recently took over as CEO of Sura, having spent his entire career with the company beforehand. He succeeded David Bojanini Garcia, who had also spent his entire career with the company.

Sources of Value

Grupo Sura itself has two economically attractive businesses with years of growth ahead in which they directly manage and own a majority, insurer Suramericana and Sura Asset Management. They additionally own 24% of Bancolombia, the leading bank in Colombia as well as more than a third each of Grupo Argos, a cement and infrastructure group and Grupo Nutresa, a food and consumer packaged goods group.

Suramericana is the sixth-largest insurance group in Latin America and the fourth largest non-life insurer in the region. It writes property and casualty (~60% of premiums), health (30%), and life insurance business (10%). The company has been growing premiums at a double digit rate and expanding beyond Colombia. More than 35% of premiums now come from outside the country.

Sura Asset Management has been a leading player in the pension business for some time and also provides financial guidance for non-pension savings to individuals. The corporate investment management side of the business has been a focus for the company and has been growing rapidly. Assets under management now totals $140 billion and rose by 15% last year.

About a year and a half ago I wrote favorably about **Bancolombia**'s biggest competitor Grupo Aval (AVAL). The Colombian banking system remains structurally attractive in the long-term. Combined, the two largest banking groups control more than half of the market. Bancolombia also has leading positions in Panama, Guatemala, and El Salvador. About two-thirds of the loan book is currently in Colombia and one-sixth in Panama, with the remaining sixth split roughly equally between Guatemala and El Salvador.

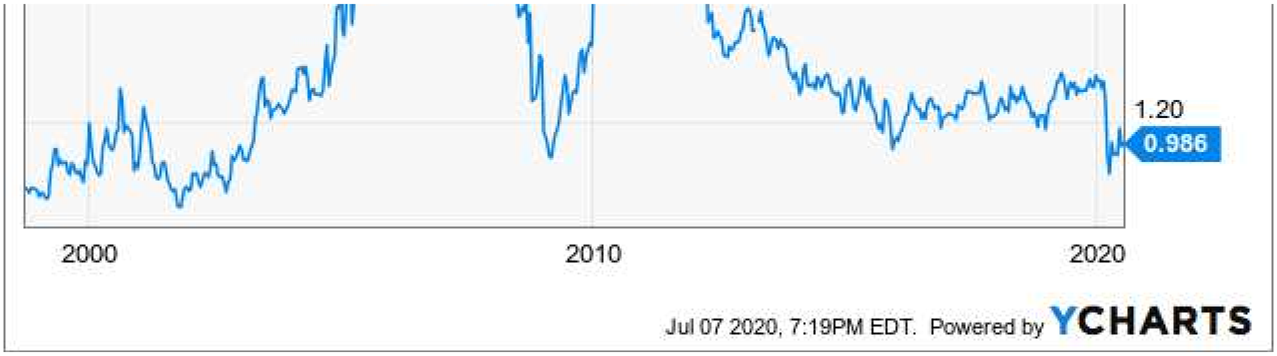
With about half of the group's market value and a quarter of its net asset value deriving from Bancolombia, among the most pertinent questions investors must grapple with is how loss reserves are likely to develop over the coming quarters.

In Colombia, the bank has offered relief programs of three months for loans to retail customers and six months for mortgages. Despite no blanket relief, businesses can obviously also negotiate for temporary relief on a one on one basis. Roughly one month ago, Bancolombia gave some clues as to how bad non-performing loan formation could ultimately be during Bank of America's Emerging Markets Debt & Equity conference. Cost of risk was 1.9% of gross loans for 2019 and rose to 2.9% in the first quarter of this year. Based upon a GDP contraction of 5% in 2020, the company expects the cost of risk to rise to 4.0% as a percentage of loans. Make no mistake about it, Bancolombia will be challenged this year. In a recent interview, CEO Juan Carlos Mora Uribe stated that the remainder of the year should be similar to March in which profits fell by 60% due both to reserve increases and impacts from looser monetary policy in Colombia. (If you speak Spanish, you can view the full interview below, which also includes the head of Scotiabank Colpatria.)

Importantly, the bank is well capitalized. At the end of Q1, tier 1 capital stood at 9.1% of risk weighted assets and should stay above minimum regulatory levels of 4.5% even if the economic situation further deteriorates. The company plans to further boost its regulatory capital ratios from various actions, including by shifting into assets with lower risk weightings. It is not impossible the dividend is cut in the future, but it has not been thus far.

Throughout the challenges of the pandemic, the bank's digital offerings have proven to be a competitive advantage and it would be surprising if it did not gain some market share. The processing of relief funds should also aid in pulling some in Colombia into the formal banking system, something Bancolombia is probably better positioned to capitalize on than rivals.

These challenges also seem well accounted for in the valuation of the stock, which now trades for roughly book value, down in U.S. dollars by half since February and matching valuations during the financial crisis.



Data by YCharts

Grupo Argos is another business in which results are going to be severely impacted this year. The group is a large cement producer, not only in Colombia but other countries as well including the United States through Cementos Argos. The Celsia division invests in energy projects and Odinsa is the name of the company's division devoted to toll roads, rail networks, and airport concessions, which include the El Dorado International Airport in Bogota, Latin America's third-largest.

Argos' business is likely to be hit harder than any other of the components of the GEA. But, again, investors have to ask how much of a discount is actually warranted? Because of the interlocking nature of shareholdings for the overall Grupo Empresarial Antioqueño, Grupo Argos owns 28% of Grupo Sura and 10% of Grupo Nutresa. It further owns 37% of Pactia, a real estate developer. Those holdings are worth ~$1.7 billion against a current market cap of roughly $2.3 billion for Argos, which also owns assets that over the previous year have generated proportionate EBITDA of about $700 million. Debt, at 3x EBITDA, is also manageable and the financial strength of the company should be buttressed from the dividends it receives this year from its portfolio.

Finally, **Grupo Nutresa** is an extremely high quality company, controlling more than half of Colombia's processed foods market and doing a further $1 billion in sales outside of the country. It trades for an undemanding trailing multiple of about 18x earnings, while its sales have been compounding at a double digit rate for a number of years.

Valuation

The group's discount to net asset value has blown out recently along with the Colombian stock market. By my calculation, it currently sits at 48%.

	Value in USD (millions)	
Sura Asset Management	$	2,348
Suramericana	$	1,680
Bancolombia	$	1,603
Grupo Nutresa	$	946
Grupo Argos	$	824

Shares Outstanding (Common + Pref), millions	582
Price Per Share in Colombian pesos	20,360
Market Cap, in millions COP	$11,849,520
Exchange Rate, COP per USD	3,640
Market Cap, in millions USD	$3,255

[illegible]	$	[illegible]	[illegible]	[illegible]
Sura Ventures / Other	$	110		
Holding Company Debt	$	(1,265)	Price to Net Asset Value	52%
Net Asset Value	$	6,246		

Grupo Sura net asset value compared to current market value. Bancolombia, Grupo Nutresa, and Grupo Argos are shown at market value. Sura Asset Management is valued at the price implied by the 2019 transaction with CDPQ, adjusted for exchange rates and discounted by 20% to reflect current market conditions. Suramericana is generally valued at 1.8x book value when Grupo Sura lists its portfolio value, but because of market conditions is valued at 1.5x book value above. Sura Ventures / Other and Holding Company Debt are presented at their balance sheet values. Source: Author.

Like most conglomerates, Sura normally trades for a discount to net assets. But, prior to the recent share slide, it often traded for a more reasonable discount to net asset value of around 30% as was the case at the conclusion of the first quarter of 2019.

The valuation presents an attractive entry point, but it should not be the end of the conversation. A return to a 30% discount, all else being equal, would imply a return of 34%. But, Grupo Sura potentially represents a hat trick in that its discount is quite a bit wider than average, the publicly traded companies that are a part of its portfolio are at discounted valuations, and all of the company's assets are set to continue compounding value at high rates in the future.

One note on the share price is important. In the United States, an ADR trades under the ticker "GIVSY." If you look up the price of these shares, you will generally see them listed at a last price of $21.25. Shares listed in Bogota currently trade for 20,360 Colombian pesos, or $5.59 converted to U.S. dollars. The ADRs represent two common shares, which implies a current ADR price of $11.19. The $21.25 price references trades made last fall. To be sure, the ADR is thinly traded, but I have not had problems recently acquiring shares with an $11 limit price from my broker. As with all thinly traded stocks, use limit orders and caution. But, with this one in particular, be sure to reference the share price in Bogota along with the most recent exchange rate before purchasing any shares.

Risks

After discussing the pandemic in some detail, there are some additional risks investors would be wise to consider.

First, as with any international investment, currency should be considered.

Colombian pesos per U.S. dollar, 1991 to present. Source: Banco de la Republica.

The peso has been in a bear market versus the U.S. dollar for about six years now after a period of relative strength between 2002 and 2014. Oil prices are the largest determinant of the value of the peso simply because of its importance to the country's exports. Investors should be aware of this relationship and the currency risk in shares of Grupo Sura.

Data by YCharts

Beyond the pandemic itself, investors should consider potential longer-term ramifications of the upheaval that it has brought. Colombia has managed through the pandemic better than almost all of its neighbors thus far, but it is difficult in the long-run to know how voters will ultimately judge the performance of current President Ivan Duque. He is a little like the portfolio manager who is down 15% when the market is down twice that. How will people ultimately view "relative results"? The final chapter of the story has still not been written yet, as it is too soon to tell what happens as the economy reopens. A great deal is at stake politically, as a recent article from Americas Quarterly lays out well. The article ends with the following summary.

> If Duque's gamble pays off - and Colombians are able to slowly get back to business without it provoking a new surge in coronavirus cases - the second half of the president's term may yield more tangible results than the first. If it backfires, and the coronavirus returns, the scandals and controversy that plagued him early on (and indeed never truly disappeared from Colombian news coverage) will only grow louder.

The next Presidential election is in 2022 and Duque is constitutionally barred from running for re-election. Should the Colombian conservative party not win, it need not be a disaster for investors. But, with the country increasingly polarized, political risk is always a reality.

Conclusion

Famed contrarian David Dreman once said, "The success of contrarian strategies requires you at times to go against gut reactions, the prevailing beliefs in the marketplace, and the experts you respect."

International stocks have appeared cheaper than American ones for some time now. Latin American stocks, too, had been in a bear market for quite some time prior to the economic and societal shocks of this year. To be sure, economic volatility is likely to persist for at least the remainder of the current year. But, Grupo Sura's stability, both financial and dispositional, should allow the group to emerge stronger from those shocks. With an asset base set to compound future value, a larger than average discount to the value of its assets, which are themselves deeply discounted, Sura could provide strong returns for contrarian investors.

Disclosure: I am/we are long GIVSY. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

Comments (4)

Richiemd00

Hi, thanks for your article really interesting

What do you think could be the trigger for the stock to go up? Grupo sura and groupo argos had had really good valuations for a long time but stock price doesn't seem to react

finally, what is your time horizon on this trade?

thanks again!

11 Jul 2020, 12:50 PM

Ohio Capital Ideas

Contributor PREMIUM

Author's reply » @Richiemd00 Thanks so much for your comment.

I think in the near term you could see cases in many LatAm countries peak in anywhere from 3-5 weeks. Oil prices will have a big impact on near term share prices as well, particularly in USD.

It's always tough to know when a cycle actually shifts. The stock peaked in 2014 at about 43k pesos versus its current price of about 20k pesos and the Colombian peso is also worth about half of it's 2014 value in dollars today. So, in USD, Sura is down about 75% from its 2014 high.

I don't have a specific time frame. You have to be willing to adjust your thesis if the facts change. So, I'm happy to hold Sura unless I have a change in thesis or the price rises above what I think the shares are worth.

11 Jul 2020, 06:07 PM

DuaneAllman

Good article.

Emerging market value stocks are the best valuations in the world but don't touch them unless you are prepared for long holding periods and big swings up & down.

It's also not easy to find a fund manager that specializes in emerging market value. The index funds are heavily weighted to China, bank and tech stock's.

09 Jul 2020, 09:59 AM

Ohio Capital Ideas

Contributor PREMIUM

Author's reply » Thanks for the comment. The valuations are pretty compelling right now. Even the LatAm focused funds are heavily weighted towards Brazil. I'd prefer to be in Mexico, Colombia, and Chile at the moment within the region. Falabella is another terrific company in Chile that's really cheap right now, but unfortunately can't be purchased through U.S brokers.

09 Jul 2020, 10:12 AM