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Colonial BancGroup Inc.

CNB - $23.93 – NYSE

New Recommendation

Recommendation: Sell Short

Reasons For Short Sale Recommendation

- Bank heavily exposed to deteriorating Florida residential construction market.
- More than half of $22.8 billion in assets are in Florida as of Dec 31, 2006.
- Lent more than 5 times the national average for banks for construction projects.
- Construction lending ratio is 413% of core capital compared to FDIC guideline of 100%.
- Making acquisitions at the top of the market, with a $1 billion-asset bank deal pending.
- Florida is undergoing one of its worst housing recessions ever, yet the bank is lowering its amount for nonperforming assets, to levels lower than many of its peers.
- Laying off workers.
- Bad news has not yet hit the financial statements.
- Company no longer offering earnings guidance.

Financials

52 – Week Low 11-3-2006	$27.27	Book Value/Shr (mrq)	$13.46
52 – Week high 6-2-2006	$57.84	Diluted Earnings/Shr (ttm)	$1.72
Daily Volume Avg.	966,229	Diluted Earnings/Shr mrq)	$0.43
52 – Week Change	-5.8%	Sales/Shr (ttm)	$5.98
Market Capitalization	$3.63B	Cash/Shr (mrq)	$6.86
Shares Outstanding	152.81M	Price/Book (mrq)	1.77
Float	144.34M	Price/Earnings (ttm)	13.81
Profit Margin (mrq)	28.91%	Price/Sales (ttm)	3.96
Operating Margin (ttm)	52.51%	Revenue (ttm)	$919.52M
Return on Assets (ttm)	1.20%	EBITDA (ttm)	NA
Return on Equity (ttm)	13.32%	Debt/Equity (mrq)	NA
Operating Cash Flow (ttm)	-$114.0M	Shares Short 3-12-07	4.36M
Leveraged Free Cash Flow (ttm)	NA	% of Float Short	3.00%
Total Cash (mrq)	$1.05B	Short Ratio3-12-07	4.6

(ttm) = Trailing 12 months, (mrq) = Most recent quarter, M = Millions, B = Billions, m = Thousands

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Business Description (10K)

The Colonial BancGroup, Inc. (BancGroup, Colonial or the Company) is a Delaware corporation organized in 1974 as a bank holding company under the Bank Holding Company Act of 1956, as amended (the BHCA). BancGroup was originally organized as Southland Bancorporation, and its name was changed in 1981. In 1997, pursuant to the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, BancGroup consolidated its various banking subsidiaries into Colonial Bank. In 2000, pursuant to the Gramm-Leach-Bliley Financial Services Modernization Act (Gramm-Leach), BancGroup elected to become a financial holding company which allows it to affiliate with securities firms and insurance companies and to engage in other activities that are financial in nature, incidental to such financial activities, or complementary to such activities.

The principal activity of BancGroup is to supervise and coordinate the business of its subsidiaries and to provide them with capital and services. BancGroup derives substantially all of its income from dividends received from Colonial Bank. Various statutory provisions and regulatory policies limit the amount of dividends Colonial Bank may pay without regulatory approval. In addition, federal statutes restrict the ability of Colonial Bank to make loans to BancGroup.

At December 31, 2006, BancGroup and its subsidiaries employed 4,721 persons. BancGroup's principal offices are located at 100 Colonial Bank Blvd., Montgomery, Alabama 36117 and its mailing address is: P.O. Box 241148, Montgomery, Alabama 36124. BancGroup's telephone number at its principal office is (334) 676-5000.

Subsidiary Bank

Colonial Bank was converted into a national association on August 8, 2003. Its legal name was changed to "Colonial Bank, N.A." but it still does business as, and is usually referred to herein as "Colonial Bank." As of December 31, 2006, **Colonial Bank had a total of 305 branches, with 166 branches in Florida, 92 branches in Alabama, 18 branches in Georgia, 14 branches in Texas and 15 branches in Nevada**. Colonial Bank conducts a general commercial banking business in its respective service areas and offers a variety of demand, savings and time deposit products as well as extensions of credit through personal, commercial and mortgage loans within each of its market areas. Colonial Bank also provides additional services to its markets through cash management services, electronic banking services and credit card and merchant services. Through its wealth management area, Colonial Bank's wholly owned subsidiaries Colonial Investment Services, Inc., Colonial Investment Services of Florida, Georgia, Nevada and Tennessee offer various insurance products and annuities for sale to the public. These subsidiaries are regulated by each state's department of insurance.

Colonial Bank encounters intense competition in its commercial banking business, generally from other banks located in its respective metropolitan and service areas. Colonial Bank competes for interest bearing funds with other banks and with many non-bank issuers of commercial paper and other securities. Competition also exists with banks in other metropolitan areas of the United States, many of which are larger in terms of capital resources and personnel. In the conduct of certain aspects of its commercial

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banking business, Colonial Bank competes with savings and loan associations, credit unions, mortgage banks, factors, insurance companies and other financial institutions. At December 31, 2006, Colonial Bank accounted for approximately 99.7% of BancGroup's consolidated assets.

Other Financial Services Operations

BancGroup's subsidiary Colonial Brokerage, Inc., a Delaware corporation, provides full service and discount brokerage services and investment advice and is a member of and is regulated by the National Association of Securities Dealers.

Non-financial Services Operations

BancGroup has interests in several residential and commercial real estate developments located in the southeastern United States as well as two in the central Texas area. The aggregate investment in such entities is $37.9 million.

As of December 31, 2005, Colonial Bank had a 72.43% ownership in Goldleaf Technologies, Inc., a Delaware corporation, which provides internet and ACH services to community banks. On January 31, 2006, Colonial Bank sold its interest in Goldleaf Technologies, Inc.

Segment Information

The Company has six reportable segments for management reporting — five regional bank segments located in Florida, Alabama, Georgia, Nevada and Texas, and the mortgage warehouse segment headquartered in Orlando, Florida. Each regional bank segment consists of commercial lending and full service branches in its geographic region. The branches provide a full range of traditional banking products as well as financial planning and mortgage banking services. The mortgage warehouse segment provides lines of credit collateralized by residential mortgage loans and other services to mortgage origination companies. Corporate functions not included in these reportable segments include treasury and parent activities, back office operations and intercompany eliminations. These functions are reported together as Corporate/Treasury/Other.

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Analysis

Colonial BancGroup (CNB) of Montgomery, Alabama has made a big bet on Florida residential construction. We believe that bet is going to be a loser. As the housing bust continues to grow, the pain is going up the line. First the consumer, then the builder and finally, the bank. All of them will experience significant problems. Those that are the most exposed are the most at risk. **CNB is heavily exposed to construction lending in Florida.** We do not see them escaping the housing recession despite what the bank claims. Banks always claim that their underwriting standards are stellar and will insulate them from everyone else's problems. We do not agree. CNB has been making increasingly larger bets at the top of the market and at the same time it is lowering its amounts for nonperforming loans. This does not pass the smell test.

We know that **Florida is currently undergoing the worst housing recession in its history**. It is also just getting started. With the collapse of the sub-prime market, and now the problems starting to show up in the Alt-A market as well, it is going to get worse, much worse. The sub-prime market accounted for 20 percent of all mortgages in 2006. Alt-A was another 20 percent of the market in 2006. So combined, sub-prime and Alt-A accounted for 40 percent of the $8 trillion mortgage market, that's $2 trillion!

Sub-prime has basically vanished and Alt-A is next. In addition, close to $1 trillion of mortgage loans are going to reset higher in 2007. With close to 40 percent of potential buyers shut out of the residential market and rapidly rising defaults that are going to increase the supply of housing, prices are only going to go down. Builders will have an extremely hard time staying in business and many will go bankrupt. **CNB is the bank that loaned the Florida builders the money.**

Florida

Although CNB is based in Montgomery, Alabama, it has made a huge bet on Florida. As of December 31, 2006, CNB had 166 branches out of 305 in Florida. **More than half of CNB's $22.8 billion in assets were in Florida** as of December 31, 2006. CNB lends money mostly to local homebuilders "well known" to loan officers. Whether they know the builders or not, there is going to be enormous pressure on these builders to stay in business. Perhaps, some of these builders were given loans that they should not have been given because of longstanding relationships? We will soon find out.

CNB has 69 percent of its assets in Florida, Nevada and Texas. All three areas are being hit by the real estate slowdown. CNB is one of the most heavily exposed banks to the once-hot Florida construction market.

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Construction Lending

Not only is CNB in the market with the biggest risk, it has also made the riskiest type of loans-construction loans. Construction loans are considered risky because if the builder defaults on the loan mid-stream, the bank can have problems trying to sell off the unfinished development for enough of a profit to cover the loan losses as opposed to selling off an automobile that a customer defaulted on.

CNB has lent $6.4 billion for construction projects, mostly in Florida, **which is five times the average for banks nationwide!** CNB has lent far more to construction borrowers as a percentage of its core capital in 2006 than recommended by the Federal deposit Insurance Corp. guidelines. Core capital is a measure of a banks financial strength. **CNB's construction lending ratio is 413 percent of core capital compared to the FDIC's minimum threshold guideline of 100 percent.**

As of December 31, 2006 **CNB had 41 percent of all loans in the construction sector**, compared to a 15 percent national average for banks. They have clearly made a large bet at the top of the market.

Top of the Market Acquisitions

During the housing boom of the last five years, CNB went on an acquisition spree that is still continuing. **Since 2000 CNB has bought six Florida banks with assets of $3.5 billion. A seventh $1 billion asset bank deal is pending.**

Loan growth has also exploded. **Real estate construction loans grew 61 percent to $6.34 billion in 2006 from $3.94 billion in 2004**. From 2002 to 2004 real estate construction loans grew by 44%. In 2002 real estate construction loans made up only 23 percent of the total loan portfolio. As of December 31, 2006 those loans made up 41 percent of all loans. So CNB grew faster right at the top of the market.

We believe that many of these loans that appeared to be winners in a bubble environment will look decidedly less brilliant in a weak housing and construction market. Future growth could be hard to come by with a glut of unsold homes on the market and more to come.

New numbers out show that the inventory of unsold homes in Florida is still getting worse. Forget about all this talk about a bottom being made in the housing market. Experts on Television were calling bottom two months ago. These same experts never saw the slowdown coming but now they call bottom without factoring in the evaporation of easy credit that had kept the game going.

In Orlando, FL the housing market has worsened in March from the previous month. **March 2007 inventory reached a record high of 23, 547 units, up 21 percent from December 2006 and up a whopping 62 percent from March 2006!** In March 2004 there were only 5,411 homes in inventory! March 2007 sales are up 20 percent month over month and **down 42 percent year over year** compared to up 27 percent month over month and up 14 percent year over year last year. March 2007 Days Of Sale

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(DOS) are at 424 days on a monthly sales rate and 339 days on a trailing 12 month absorption basis. Median sales price of $240K is flat with the previous year, but down 5.9 percent month over month.

D.R. Horton Inc., the nation's largest homebuilder by deliveries, said Tuesday its **second-quarter sales orders fell 37 percent,** led by even steeper declines in California and the Southwest. **Their cancellation rate for the second quarter was 32 percent.**

Lennar Corporation, one of the nation's largest homebuilders, based in Miami Florida, reported **revenue down 14 percent, new orders down 27 percent and a cancellation rate of 29 percent** for the quarter ended February 28, 2007! **Nothing is getting better!**

Population growth in Florida is also starting to change. One of the bullish arguments on Florida real estate is that there is a never ending flow of retirees into Florida and thus there will always be demand for high price real estate. According to an article in the South Florida newspaper the Sun-Sentinel on March 22, 2007 "HAS THE LUSTER FADED? BROWARD LOSING MANY RESIDENTS, ALTHOUGH GROWTH IS UP SLIGHTLY" According to the article Migration flows in Florida are moving the wrong way for the housing industry. The old folks are heading half way home, and the young ones are moving to less crowded areas where the cost of living is lower. The result is a sea change in Broward's makeup. A new neighbor is much more likely to be a newly arrived immigrant than a U.S. retiree from New York, or a young couple from the Midwest. Between 2000 and 2006, the census data show, five new immigrants came to Broward for every person arriving from inside the United States. **That's a complete reversal from the 1990s, when one immigrant arrived for about every two newcomers from within the country."** Immigrants generally have much less money than retirees from New York and elsewhere.

Lowering Reserves!

Despite conditions in Florida continuing to deteriorate, CNB has been lowering its amounts for nonperforming assets. **Last year CNB lowered its amount by 21 percent to 425 million, for a nonperforming asset ratio of 0.16 percent, which is lower than many of its peers.** Yet it also has laid off 400 workers and will no longer give earnings guidance? If everything is still so good and apparently getting better, why would you lay off workers and not give guidance? Something doesn't smell right here and we know what it is-denial. How anyone can buy that with a straight face is a mystery to us. By lowering reserves a bank increases it's profits pure and simple. But it is only a matter of time, a short time we believe, before reality will show up in the financial statements.

CNB's earnings are not estimated to grow this year as it is. At around 14 times earnings it is more expensive than many of its peers that trade at about 12.9 times. We believe that non performing loans are going to increase substantially over the next 18 months and that CNB's share price is at a significant risk to take a substantial hit. We advise investors sell CNB with a price target of $17 within the next 12 months. Sell.

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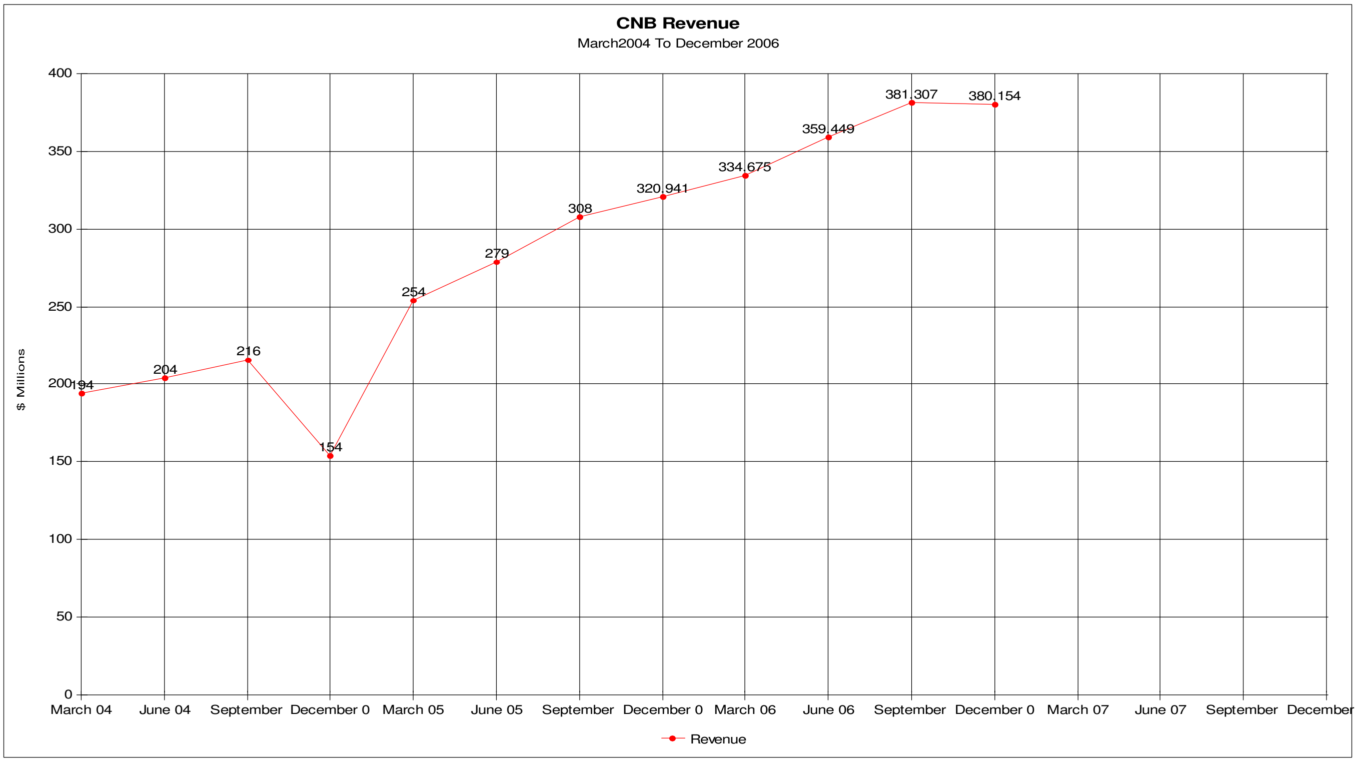

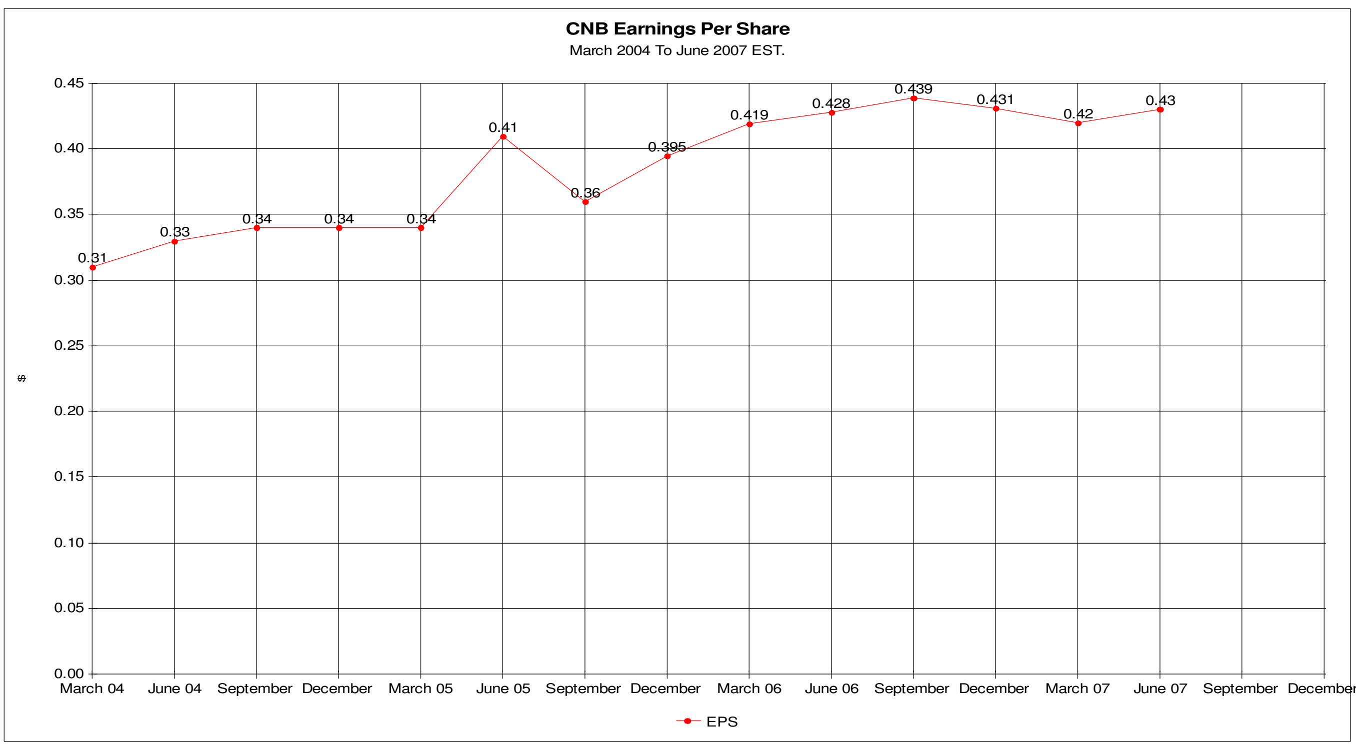

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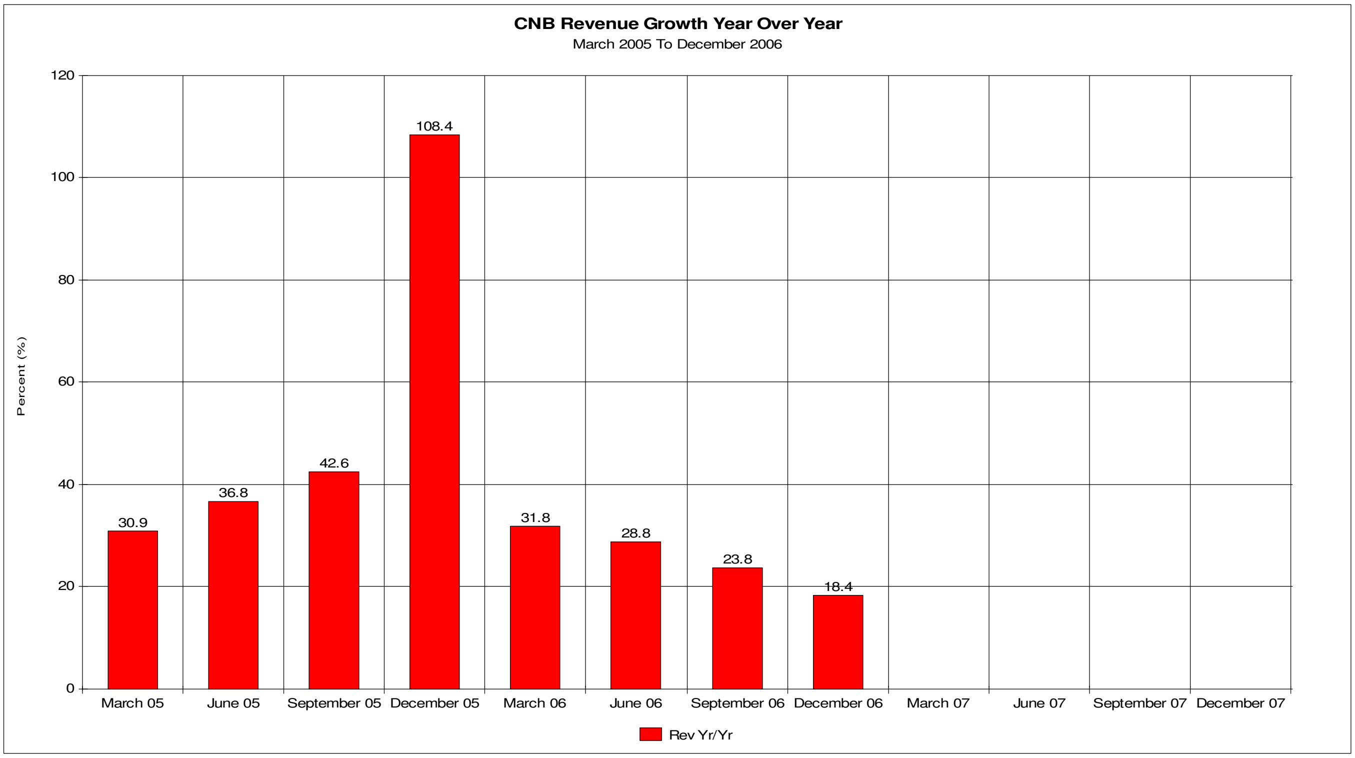

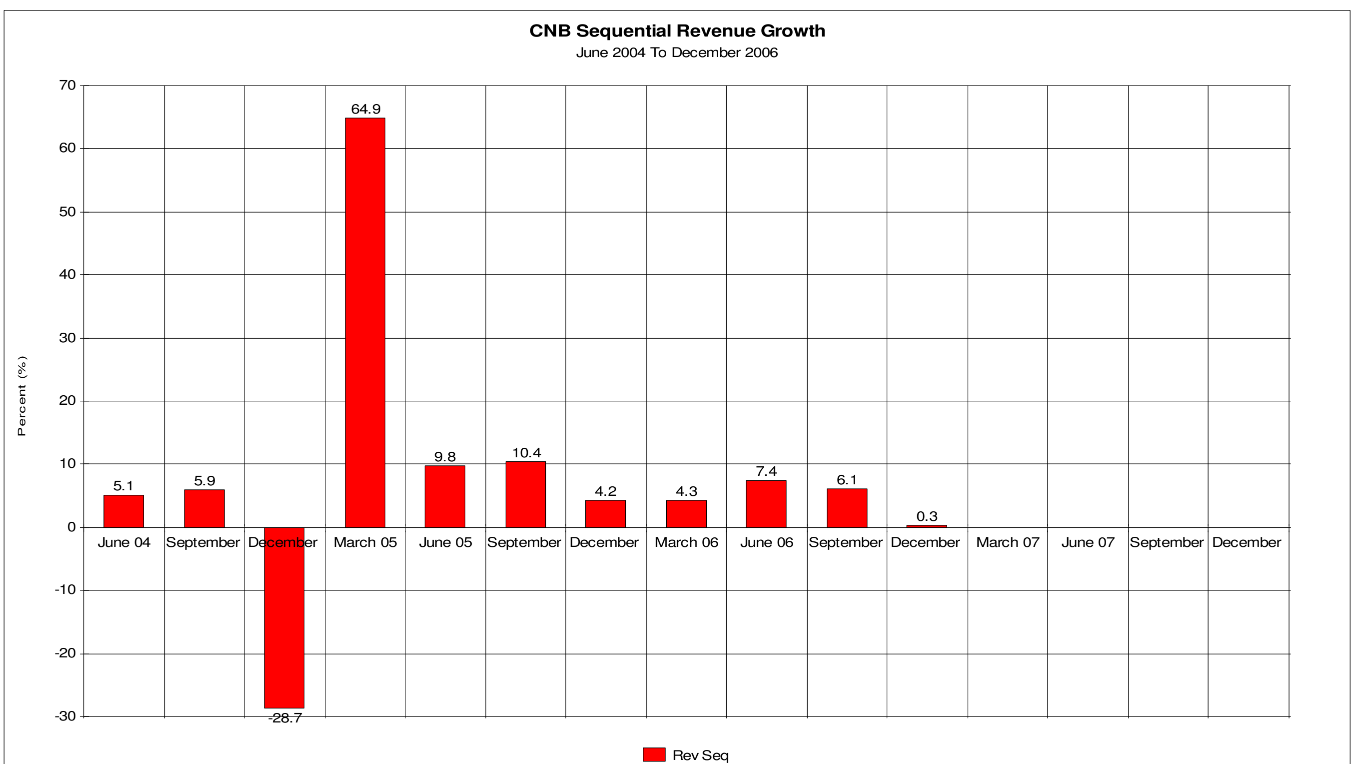

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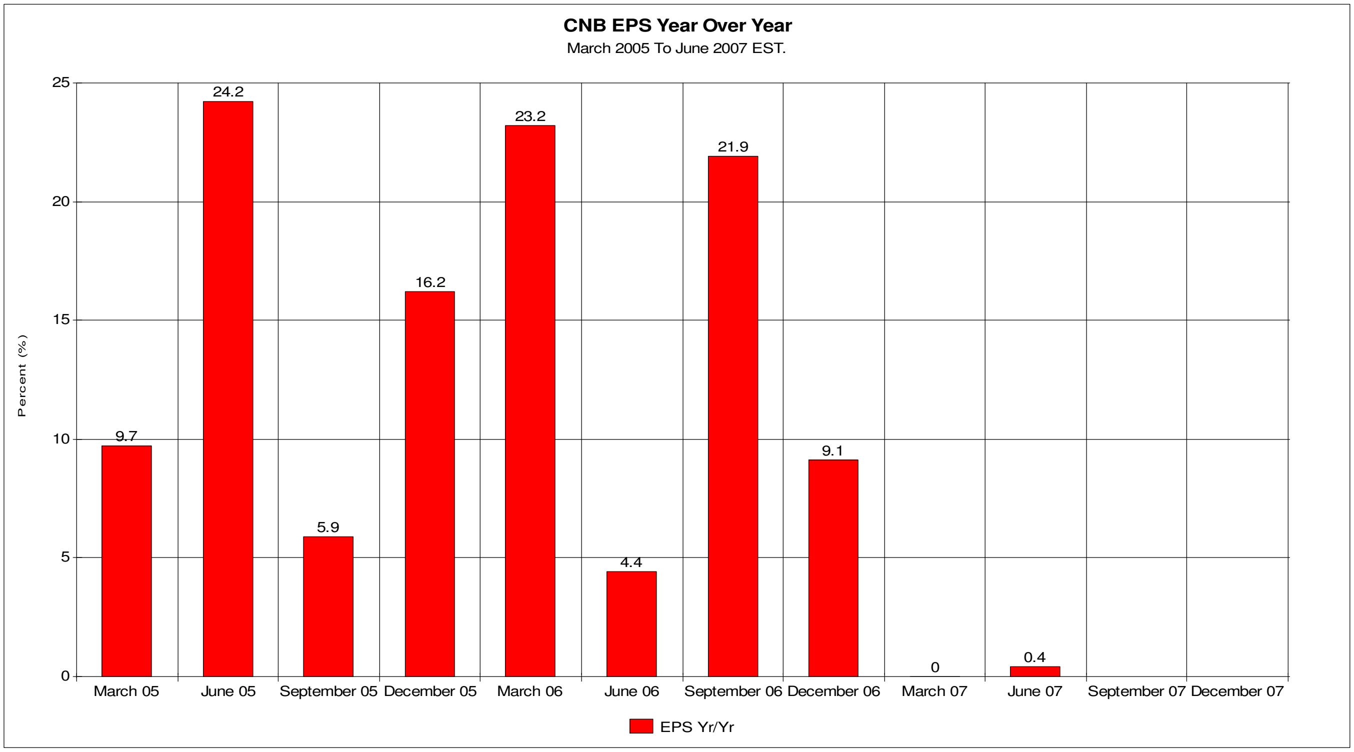

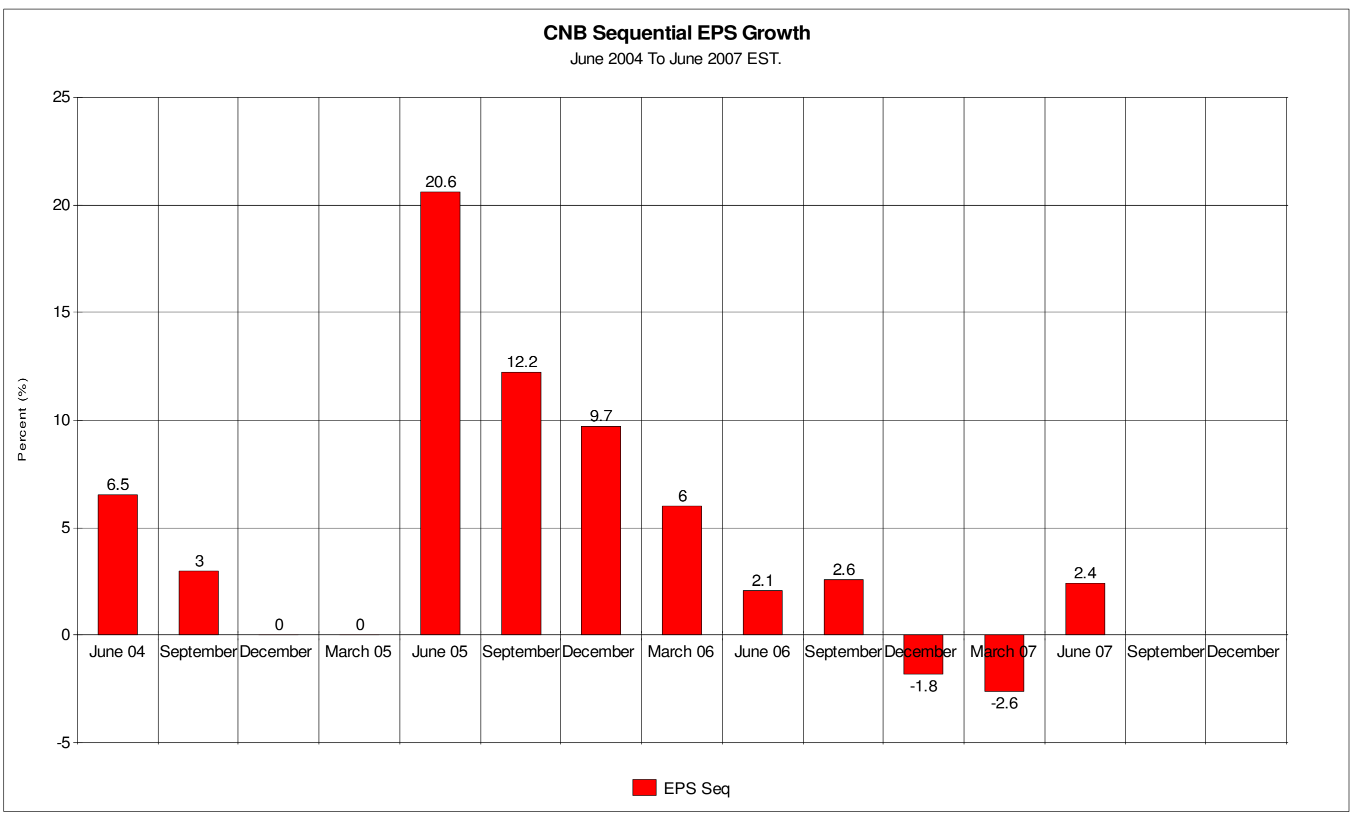

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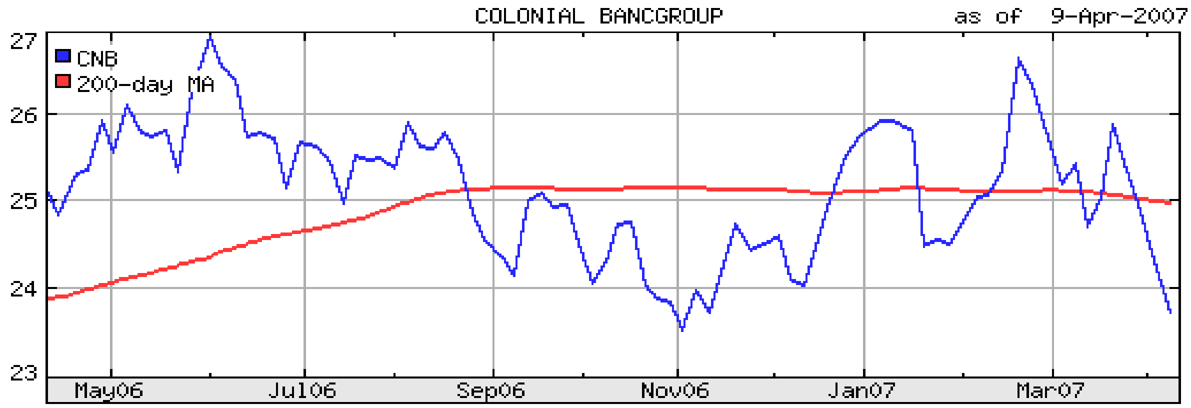
CNB 1 Year Chart



CNB 5 Year Chart