3Q2023 CONSOLIDATED EARNINGS RESULTS CALL TRANSCRIPT

GRUPO AVAL ACCIONES Y VALORES S.A.

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Operator: Welcome to Grupo Aval's Third Quarter 2023 Consolidated Results Conference Call. My name is Krista, and I will be your operator for today's call. Grupo Aval Acciones y Valores S.A., Grupo Aval is an issuer of securities in Colombia and in the United States SEC. As such, it is subject to compliance with securities regulations in Colombia and applicable U.S. securities regulation. Grupo Aval is also subject to the inspection and supervision of the Superintendency of Finance as holding company of the Aval financial conglomerate.

The consolidated financial information included in this document is presented in accordance with the IFRS as currently issued by the IASB. Details of the calculations of non-IFRS measures such as ROAA and ROAE, among others, are explained when required in this report. Banco de Bogota executed a spin-off of 75% equity stake in BAC Holdings International Corp, BHI, to its shareholders and Grupo Aval subsequently spun-off its equity interest to its shareholders on March 29, 2022. On December 19,

2022, Banco de Bogota sold 20.89% of the outstanding investment of BHI through a tender offer. As of December 31, 2022, Banco de Bogota held 4.11% of BHI. This investment is reflected as an investment at fair value through other comprehensive income.

Following the sale, the equity method recognized under the share of profit of equity accounted investees, net of tax equity method between April and November was reclassified to discontinued operations. For comparability purposes of this presentation, we have reclassified BHI's equity method for the second and third quarter of 2022 to net income from discontinued operations. Banco de Bogota's remaining 4.11% interest in BHI was disposed of in March 2023.

This report includes forward-looking statements. In some cases, you can identify these forward-looking statements by words such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential or continue or the negative of these words and other comparable words. Actual results and events may differ materially from those anticipated herein as a consequence of changes in general, economic and business conditions, changes in interest and currency rates and other risks described from time to time in our filings with the Registro Nacional de Valores y Emisores and the SEC.

Recipients of this document are responsible to the assessment and use of the information provided herein. Matters described in this presentation and our knowledge of them may change extensively and materially over time. We expressly disclaim any obligation to review, update or correct the information provided in this report, including any forward-looking statements, and do not intend to provide any update for such material developments prior to our next earnings report. The content of this document and the figures included herein are intended to provide a summary of the subjects discussed rather than a comprehensive description. When applicable in this document, we refer to billions as thousands of millions. [Operator Instructions]

I will now turn the call over to Mr. Luis Carlos Sarmiento Gutierrez, Chief Executive Officer. Mr. Luis Carlos Sarmiento Gutierrez, you may begin.

Luis Carlos Sarmiento Gutierrez

President

Good morning, and thank you all for joining our third quarter 2023 conference call. Before Diego provides a detailed look at our numbers, I will provide an overview of Colombia's macro scenario, also an update on recent changes at the top of 3 of our 4 Colombian banks and I will finish with some highlights of our financial performance during this quarter and our view for 2024.

Let's start with the macroeconomic scenario. After central banks around the world hiked rates to contain inflation, it is the consensus that a maximum level of rates has been reached, and therefore, we should see easing in monetary policies during 2024. In fact, before Mr. Powell from the U.S. Federal Reserve delivered his assessment of monetary policy in the U.S. this past August, it was a market consensus that the U.S. would be the first developed country to start a path of easing rates. However, that changed after Mr. Powell cautioned against over-optimism and instead declared that the Fed would proceed slowly to lower rates and that it wouldn't do so until abundant evidence existed that inflation was contained and trending towards 2%. In any case, the growth prospects of the U.S. economy have significantly improved.

In Europe, business activity has remained stronger than expected despite higher interest rates and the conflict in Ukraine. On the other hand, the Chinese economy has delivered disappointing results. The International Monetary Fund anticipates a still sluggish performance of global economic growth with a projection of 2.9% in 2024, slightly down from the 3% expected for this year. This updated forecast incorporates a divergence in growth trajectories among developed and emerging economies around the world.

In Colombia, domestic demand continued to decelerate and [house] sales dropped sharply as the cost of debt rises and weighs heavily in a typical family's monthly revenue. This has negatively impacted economic growth, which only amounted to an adjusted 0.4% in the second quarter and minus 0.3% in the third quarter. On the other hand, social services, basically subsidies geared to the elderly population, mitigated the softer consumption of goods. Additionally, while primary activities and services improved, the weakness of manufacturing and construction persisted. Agriculture has improved as El Nino has delayed its arrival, especially benefiting coffee crops. And oil production has not dropped as much as it was first thought after the government's drastic announcements.

Accordingly, we now anticipate GDP growth of approximately 1% in 2023 and a 1.5% to 1.75% for 2024. Inflation fell less than expected in the third quarter, reaching 11% in the previous 12 months. And consequently, expectations for annual inflation during 2023 were revised upwards. Monthly inflation during October came in at 0.25%, below market consensus of 0.36% and brought 12-month inflation to 10.48%. Inflation during the last 2 months of the year will heavily depend on prices of regulated goods, especially gasoline prices, which are expected to increase COP 600 per gallon in November, energy tariffs that are highly dependent on the arrival of the El Nino phenomenon and tolls which are expected to increase 13.25% before year end.

With this in consideration, annual inflation will likely end 2023 in the 9.6% area. We expect that inflation during 2024 will moderate down to 6%. Regarding interest rates, if the trend inflation persists, the Central Bank might cut interest rates by 25 basis points in its December meeting, bringing the repo rate to 13%. In line with inflation, we expect additional repo rate reductions of approximately 500 basis points during 2024, ending the year at approximately 8%.

Employment data has lagged economic performance, and this is evidenced by a favorable trend in the labor market, which continued during the third quarter. In fact, despite softer economic data, the latest unemployment rates released by [Dun] shows that in September unemployment decreased to 9.3%, improving from 10.7% observed a year before. However, October data indicates that new job creations are slowing down and that the mentioned lag is fading. Consequently, we are anticipating an increase in the unemployment rate to 11% by year end 2023, holding at that same level during 2024. Obviously, if the economy grows less than expected or in our point of view, if Congress approves the proposed labor reform, unemployment will be exacerbated.

Regarding the exchange rate, although surrounded by ample volatility, the Colombian peso has appreciated approximately 18% during the year. In fact, just this week, it dropped under COP 4,000 per dollar. One of the primary drivers of a stronger Colombian peso, in addition to the global weakening of the dollar, appears to be the generalized perception that the most concerning aspects of the health, labor, pension fund and other reforms are less likely to be approved in Congress, particularly following the recent regional election results in which mostly members of opposition political parties were elected governors, mayors and city council members.

Another contributing factor is a steep decline in imports which has decreased the trade balance deficit. Looking forward, the exchange rate will continue to experience heavy volatility influenced by external factors like interest rates in the U.S. We expect that once the Central Bank initiates its interest rate cut cycle, the peso could experience some depreciation due to the reduction in the current interest rate differential with the U.S.

On the fiscal front, even though the central government's fiscal deficit for 2023 was revised upward to 4.3% of GDP from the previous estimate of 3.8%, recent statements from the Ministry of Finance suggests that the final figure should be in proximity to the original estimate. Contributing to this correction are; first, tax collections, which remain robust despite weaker economic activity own to the effects of the 2 recent tax reforms. Secondly, the government's continued plan to reduce the deficit associated with fuel subsidies by raising gasoline prices, including 2 additional gasoline price hikes announced for November and December. And thirdly, for better or for worse, the inability of government to execute public spending budgets to the tune of approximately COP 40 trillion. However, despite these recent positive developments for 2023, there are several risks to the fiscal outlook for 2024. Government spending at the central level is projected to increase by 12% in nominal terms, reaching 25% of GDP, in line with a larger fiscal deficit of 4.5% of GDP.

Moving on, as some of you might have seen in the news, during the last few months, 3 of our 4 Colombian bank's presidents have changed. We are very optimistic that these changes will serve towards refreshing corporate strategies. In Banco de Bogota, Cesar Prado, who joined Grupo Aval in 2010 after having served as Superintendent of Finance, assumed as President of the bank during the month of July. Cesar has served in various roles at Aval, most recently as President of Banco de Occidente since 2018. Cesar replaced Alejandro Figueroa, who retired after very successfully leading the bank for 35 years as President.

Gerardo Silva replaced Cesar Prado as President of Banco de Occidente. Gerardo is a seasoned banker who has held several roles in Banco de Occidente since he joined the bank in 1994, most recently as VP of Corporate Banking since 2014. In Banco Popular, Maria Fernanda Suarez recently took over as President of the bank, replacing Carlos Upegui, who resigned during September. Maria Fernanda has over 25 years of experience both in the private and public sectors, most recently as President of Accenture, Columbia. She had previously served as Minister of Mines and Energy and also Executive VP of Strategy and Finance at Ecopetrol. Between 2004 and 2010, she had worked in Grupo Aval's Porvenir where she held various roles unto becoming Chief Investment Officer. And now let's move on to a Aval's financial results in the third quarter. This quarter's lackluster performance fell largely in line with our expectations and last quarter's guidance and key business metrics such as growth, cost of risk, banking NIM, fee income and contribution from our investments in the non- financial sector. However, we were negatively impacted by an unanticipated downturn in financial markets, which affected our investment portfolios carried at fair value and our NIM on investments.

Let's examine some of these. First, growth of our loan portfolios during the quarter rose to 1.1%, which compares favorably to GDP growth and far exceeded growth of our peers. As we set out to do at the beginning of 2023, we have grown our market shares across all loan categories, resulting in a gain of over 50 basis points, both on a year-to-date and on an annual basis. We will strive to continue gaining share over the next quarters, while we continue to follow a strict pricing discipline. Second, as anticipated in our last call, NIM on loans of our banking operations continued to recover this quarter up to approximately 5% despite continued pressures in cost of funds. In fact, the cost of funds during the quarter was driven by a tight liquidity market during July, August and most of September.

This negatively affected our bank's plans to reduce rates paid to wholesale savings accounts and time deposit renewals. However, we maintain our expectation of an improvement in banking NIM during the last quarter of this year as the cost of funds will begin to subside once the government starts to execute budgets, irrigating those funds currently retaining the Central Bank into the financial system and also once the central bank starts cutting rates. Notably, the superintendency of finance adjusted the weights of 2 major NSFR factors effective end of month September, bringing some relief to liquidity in the system.

Third, cost of risk increased to 2.53% in the third quarter in line with our expectations has deteriorated unsecured consumer loans drove to higher delinquency and require further impairment charges. On a positive note, our forecast of a slowdown in past due loan formation materialized both in 30 and 90-day metrics. Consequently, cost of risk likely peaked during this quarter.

Fourth, cost control initiatives deployed throughout the year enabled a 4.1% reduction in OpEx compared to a quarter earlier, despite a 7.2% increase in operating taxes and deposit insurance. Operating taxes and deposit insurance accounts for 34% of administrative expenses. We remain focused on achieving further efficiencies. Fifth, the contribution of our infrastructure non-financial sector investments remained relatively flat compared to a quarter earlier and was lower than in the past, explained by projects moving from the construction to the operation space.

Finally, regarding our NIM on investments, this quarter marks the worst quarter since we adopted IFRS back in 2014 because of negative valuations of our portfolios carried at fair values, resulting from a material deterioration in the fixed income and equity markets, coupled with the current high cost of funds. Our subsidiaries investment portfolio as reflected the downturn in peso and dollar-denominated Colombian sovereign debt linked to external factors like the Federal Reserve's increasingly hawkish view and to local factors like the persistence of inflation. Going forward, these portfolios could benefit from a falling interest rate environment.

Finally, we view 2024 as a year of transition and the path to return to our profitability targets some time in 2025. We forecast our banking segment's profitability will recover driven by higher NIM, lower cost of risk and the positive effects of cost control initiatives implemented in 2023. We expect that the lower risk profile of our loan portfolio will continue to be a competitive advantage relative to our peers throughout the remainder of this challenging cycle.

During 2024, we will continue to build our digital payments ecosystems as our bank's digital clients surpassed 5 million, clients of our digital wallet DALE increased as much as they did during 2023 or approximately 2 million and our digital transactions as a percentage of total transactions continue to register numbers in excess of 65%. We expect Porvenir to have a similar performance in 2024 relative to 2023 as the recovery of returns on its stabilization reserves will offset a slowdown in fee income related to a weaker job market compared to 2023.

We understand the importance of undertaking new non-financial investments through Corficolombiana. And therefore, we are in the process of building a pipeline of projects and possible investments, both in Colombia where an infrastructure agenda is still to be well defined by the government and abroad.

We're optimistic as we consider some of our options, but it's still too early to tell whether any of these will materialize into actual opportunities. In the meantime, Corficolombiana will remain pressured by high financing costs and by lower income from its current toll roads. I thank you for your attention. And now I'll pass on the presentation to Diego, who will explain in detail our business results and provide guidance for this year and 2024.

Diego Fernando Solano Saravia
Chief Financial Officer

Thank you, Luis Carlos. Beginning on Page 6. Assets increased 0.2% during the quarter and 4.5% over the year. Year-on-year, net loans and fixed income investments gained weight, while unconsolidated equity investments decreased their share. Our mix remained relatively stable over the quarter.

Moving to Page 7, we present the evolution of our loans. Gross loans increased 1.1% during the quarter and 6.5% year-on-year. Peso-denominated loans increased 1% during the quarter and 8.9% over the year. Despite tighter origination policies, quarterly and annual growth of our loan book was stronger than that of our peers, linked to market share gains in all loan categories. Year-on-year increase in market shares were 50 basis points for total loans, 44 basis points for commercial loans, 112 basis points for consumer and 28 basis points for mortgages.

Commercial loans grew 1% over the quarter and 7.2% year-on-year. Growth came primarily from working capital loans, while demand for CapEx loans continued to be soft. Consumer loans grew 1% over the quarter and 5.2% year-on-year. High interest rates, slow economic activity and softer macro outlook continued to underpin a sluggish performance of consumer loans.

Payroll loans account for 55% of our consumer portfolio, followed by personal loans, credit cards and other loans that account for 24%, 12% and 9% respectively. Personal loans grew 1.5% over the quarter, adding 0.2% year-on-year. Credit cards grew 1% quarter-on-quarter and 12.6% year-on-year, while automobile loans grew 0.5% and 3.8% during the same period. Personal loans growth decelerated to 0.1% during the quarter, accumulating a still strong 15.3% 12-month growth.

Finally, mortgages grew 2% over the quarter and 6.8% year-on-year, recovering from a slow first half due to changes introduced by the government to its social housing program. We expect loan growth to remain soft across products and segments in line with the Central Bank policies and a softer local and global economic outlook. On Pages 8 and 9, we present several loan portfolio quality ratios. The quality of our loan portfolios measured by stages remained relatively stable over the quarter. 30-day PDLs increased to 5.3%, an 18 basis points deterioration over 3 months and 94 basis points over 12 months, while 90-day PDLs were 3.8%, a 23 basis points deterioration over 3 months and 56 basis points deterioration over 12 months. Although still high, PDL formation on a 30-day basis improved for the second quarter in a row. 90-day- plus PDLs improved as well relative to second quarter. PDL formation reflects an improvement in the 30-day horizon in both commercial and retail loans. Quarter-on-quarter, PDL formation for consumer loans decreased 22% and 11% on a 30-day and 90-day basis respectively, driven by an improvement in personal loans and credit cards.

Cost of risk net of recoveries was 2.5%, up from 2.2% a quarter earlier and 1.4% in third quarter 2022. We expect that cost of risk of the current credit cycle has peaked very likely during the quarter we are now reporting. Tighter origination policies have shown positive signs in new vintages. In addition, our mix overweighted in payroll lending and underweighted in personal loans and credit cards has been protective during this cycle. Even though milder than our peers, we expect our cost of risk to remain high in the following quarters as the weaker vintages in personal loans and credit cards originated between August 2022 and February 2023 completed deterioration cycle and are fully impaired and ultimately charged off.

Finally, the ratio of charge-offs to average 90-day PDLs was temporarily low at 0.5x. We expect it to increase back to closer to 0.7x over the following quarters.On Page 10, we present funding and deposit evolution. Funding grew 0.7% during the quarter and 5% over the year. Peso-denominated funding increased 1.7% during the quarter and 13.7% over the year. Deposits that account for 72% of our funding remained stable over the quarter and grew 8.3% year-on- year. Time deposits reached 49.2% of our deposits. Pressure on cost of funds remained high during the quarter. This resulted from compounding high Central Bank rates with an unusually high spread between deposits and sovereign rates.

The distortion in these spreads resulted from low liquidity in term funding induced by a low government budget execution and a concentration of time deposit maturities in the system during the quarter as an aftershock of the changes to net stable funding ratios. As mentioned by Luis Carlos, pressure on deposit rates subsided towards the second half of September as the Superintendency of Finance made some transitory adjustments to the net stable funding ratio. Our deposit to net loan ratio remained flat at 101%.

On Page 11, we present the evolution of our total and attributable equity and the capital adequacy ratio of our banks. Our total equity remained flat over the quarter, while our attributable equity decreased 0.5%. This was driven by lower net income and an unfavorable valuation of fixed income investments held through OCI at fair value. All of our banks remained materially at the same Tier 1 and total solvency levels as a quarter earlier. Although this will only be reflected in our following quarterly report, I would like to mention that Banco Popular strengthened its total solvency during October with the issuance of COP 250 billion, 10 [non-qualified] subordinated local instrument.

On Page 12, we present our yield on loans, cost of funds, spread and NIM for Grupo Aval and for our banking segment. Our quarterly NIM fell 63 basis points quarter-on-quarter to 2.8% despite an improvement in our NIM on loans. The contraction of our NIM was driven by a negative NIM on investments that resulted from poor capital markets performance that dragged our subsidiaries investment fixed income portfolios at fair value through P&L and Porvenir stabilization reserves. NIM on loans continued to improve, increasing 16 basis points to 4.2%. Despite the pressure on cost of funds we have described, the stable central banking intervention rate allowed our yield on loans to increase 35 basis points during the quarter, while our cost of funds increased 18 basis points. The pressure on funding continued to delay a deeper improvement in our NIM. The NIM of our banking segment contracted 35 basis points to 3.9% during the quarter with NIM on loans expanding to 5% and NIM on investments falling to negative 1.8%.

The NIM on retail loans of our banking segment continued improving and expanded 25 basis points. The NIM on commercial loans of our banking segment contracted 8 basis points over the quarter as funding costs were temporarily pressed by the liquidity context. We have seen cost of funds come down since mid-October as the concentration of time deposit maturities is mostly over and government budget execution starts to pick up. This has allowed the spreads between both time deposits and savings relative to sovereign risk to start correcting, particularly in instruments with longer maturities.

Moving to Page 13, we present net fees and other income. Net fee income increased 15.1% year-on- year and decreased 2.8% quarter-on-quarter. Gross fee income increased 12.1% year-on-year and decreased 1.2% quarter-on-quarter. Both pension and trust fees decreased over the quarter due to lower performance-based management fees, driven by negative returns on financial markets. Banking fees increased 1.1% in line with loan growth. Income from the non-financial sector was stable relative to a quarter earlier.

On the bottom of the page, quarter-on-quarter variation of other operating income is mainly explained by a higher income from derivatives and FX gains related to our financial operations, partially offsetting the negative impact of fair value investments in fixed income in our NIM on investments. In addition, our banks and subsidiaries carried out property, plant and equipment optimization plans that resulted in income recorded under other income.

On Page 14, we present some efficiency ratios on a comparable basis. Cost to assets of 2.7% improved 11 basis points relative to a quarter earlier and remained flat year-on-year, incorporating the results of our Group-wide cost containment efforts. Cost to income increased to 54.8% over the quarter, driven by the sluggish performance of our investment portfolios at fair value. Quarterly expenses fell 4.1% quarter- on-quarter and grew 6.9% year-on-year. Administrative expenses decreased 7.2% quarter-on-quarter and increased 7.2% year-on-year. Administrative expenses have been pressed by a 44% year-on-year increase in operating taxes, particularly industry and commerce tax, that accounts for 31% of quarterly administrative expenses.

In addition, deposit insurance costs increased 20%, now accounting for 13% of our quarterly administrative expenses. This explains 10.2 percentage points and 2.4 percentage points of the administrative expenses year-on-year growth. The remaining administrative expenses categories contracted 8.3% year-on-year and 16.3% quarter-on-quarter on aggregate.

Personnel expenses fell 3.9% over the quarter and grew 3.4% year-on-year, well below the 16% increase in minimum wage in Colombia.

Finally, on Page 15, we present our net income and profitability ratios. Attributable net income for the quarter was COP 65 billion or COP 2.7 per share, bringing year-to-date attributable net income to COP 656 billion or COP 27.6 per share. Our return on average assets and our return on average equity for the quarter were 0.4% and 1.6% respectively, bringing year-to-date annualized return on average assets and return on average equity to 0.8% and 5.3% respectively.

Before moving into questions and answers, I will now summarize our general guidance for 2023 and 2024. Our guidance for 2023 remains relatively the same as on our last call, except for an update on NIM due to this quarter's poor performance on investments and a slight increase in cost of risk. We now expect 2023 consolidated NIM to be in the 3.3% area with consolidated NIM on loans in the 4% area. This builds on the NIM of our banking operation in the 4.2% area with NIM on loans in the 5% area. We now expect our cost of risk net of recoveries to be in the 2.1% area.

The rest of our previous guidance for 2023 remains the same. Loan growth in the 4.5% to 5% range with commercial loans growing in the 5.5% to 6% range and retail loans growing in the 3% to 4% range. Cost to assets in the 2.75% area. Income from the non-financial sector of 60% of that for 2022 and fee income ratio in the 20% to 25% area. As a result, we now expect our 2023 return on average equity to be in the 5% area.

Regarding 2024, we are expecting loan growth in the 10.5% area with commercial loans growing around 9.5% and retail loans growing around 12%. NIM in the 4.1% area with NIM on loans in the 5% area. NIM of our banking segment in the 4.8% area with NIM on loans in the 5.5% area. Cost of risk net of recoveries in the 2% area. Cost to assets in the 2.7% area. Income from the non-financial sector of 60% of that for 2023. A fee income ratio in the 20% to 25% area with 19% for our banking segment. And finally, we expect our 2024 return on average equity to be in the 8.5% to 9% range. We are now open for questions and answers.

Question and Answer

Operator

[Operator Instructions]

And we have no questions at this time. Mr. Luis Carlos Sarmiento Gutierrez, I turn the call back over to you.

Luis Carlos Sarmiento Gutierrez

President

All right. Thank you, Krista. I think maybe this time around, as Diego said in his presentation, our guidance for good or bad, but our guidance was right on. And besides that, well, as we all know, the country has now entered into a path of shrinkage. And hopefully, we will be able to compensate that and ride on the coattails of the economic recovery. Other than that, we're working very, very hard in putting together a year of recovery, a transition year for 2024, as we also said.

So hopefully, we'll be delivering news in accordance with our strategy. And we'll be happy to share everything with you, as we always do. And we'll be as timely with our presentations and accurate as we have always been. And therefore, we'll meet everybody again when we come up with our results for the whole 2023, and hopefully, we'll have good news as 2024 begins. I thank you all for joining the call, and we'll see you next time.

Operator

Thank you, ladies and gentlemen. This concludes today's conference call. Thank you for participating. You may now disconnect.