



## 3Q2018 CONSOLIDATED EARNINGS RESULTS CALL TRANSCRIPT

GRUPO AVAL ACCIONES Y VALORES S.A.



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# THIRD QUARTER 2018 CONSOLIDATED EARNINGS RESULTS CALL TRANSCRIPT

## Operator

Welcome to Grupo Aval's Third Quarter 2018 Consolidated Results under IFRS Conference Call. My name is Jessie and I will be your operator for today's call. At this time, all participants are in a 'listen only' mode, later we will conduct a 'Question and Answer' session. During the 'Question and Answer' session if you have a question please press \*1 on your touchtone phone. Please note that this conference is being recorded

Grupo Aval Acciones y Valores S.A. (Grupo Aval) is an issuer of securities in Colombia and in the United States, registered with Colombia's National Registry of Shares and Issuers (Registro Nacional de Valores y Emisores) and the United States Securities and Exchange Commission (SEC). As such, it is subject to the control of the Superintendence of Finance and compliance with applicable U.S. Securities regulations as a "foreign private issuer" under Rule 405 of the U.S. Securities Act of 1933.

All of our banking subsidiaries (Banco de Bogotá, Banco de Occidente, Banco Popular, and Banco AV Villas), Porvenir and Corficolombiana, are subject to inspection and surveillance as financial institutions by the Superintendence of Finance. Although we are not a financial institution, as a result of the

enactment of Law 1870 of 2017 also known as "Law of Financial Conglomerates", starting on February 6, 2019, Grupo Aval will be subject to the supervision and regulation of the Superintendence of Finance. Grupo Aval as the holding company of its financial conglomerate will become responsible for the compliance with capital adequacy requirements, corporate governance standards, financial risk management, and internal control framework and criteria for identifying, managing and revealing conflicts of interest, applicable to its financial conglomerate.

The unaudited consolidated financial information included in this document is presented in accordance with IFRS as currently issued by the IASB. Details of the calculations of non-GAAP measures such as ROAA and ROAE, among others, are explained when required in this report.

The results for 1Q2018, 2Q2018 and 3Q2018 are not comparable to previous quarters due to the prospective adoption in Colombia of IFRS 9 and IFRS 15 starting in January 1, 2018.

The previously reported figures for 2Q2018 had been adjusted to reflect the treatment of provision charges to stage 3 loans as described under IFRS 9 and detailed in KPMG's practical guide to IFRS standards whose content we learnt post the 2Q2018 conference call and that clarifies the methodology that needs to be used to fully adopt this new standard.

This report may include forward-looking statements, which actual results may vary from those stated herein as a consequence of changes in general, economic and business conditions, changes in interest and currency rates and other risks factors as evidenced in our Form 20-F available at the SEC webpage. Recipients of this document are responsible for the assessment and use of the information provided herein. Grupo Aval will not have any obligation to update the information herein and shall not be responsible for any decision taken by investors in connection with this document. The contents of this document and the unaudited figures included herein are not intended to provide full disclosure on Grupo Aval or its affiliates.

When applicable, in this document we refer to billions as thousands of millions.

I will now turn the call over to Mr. Luis Carlos Sarmiento, President and CEO of 'Grupo Aval', Mr. Sarmiento you may begin.

[Luis Carlos Sarmiento Gutiérrez](#)

[Chief Executive Officer](#)

Thank you very much Jessie.

Good morning everyone and thanks for joining our 2018 3Q results conference call. This quarter's very strong net income is a demonstration of our Grupo Aval's strategy of business diversification, especially in infrastructure, can often mitigate a very low growth environment of our core banking business. As you know, our business strategy

combines a market-leading presence in the banking sector in Colombia and the six (6) countries in Central America as well as a leading role in the Colombian assets under management business through a pension fund manager and several trust companies and just as important significant investments in non-financial sectors such as energy, hotels, agroindustry and infrastructure through 'Corficolombiana', our chosen vehicle to make such investments. These non-financial sectors were chosen because they represent diversified sources of sustained and high-growth revenues, which in Colombia and for us, will be key in the next 3 to 5 years. We strongly believe that our strategy is a strong differentiating factor between us and our local banking peers.

I also believe that we are making decisive progress in our digitalization efforts, I will refer to the positive impact on our results of Corficolombiana's infrastructure business and to our digitalization efforts in a few minutes. I will also address the issue of charges brought against us by the Superintendence of Industry and Commerce, which is the antitrust supervisor in the country, in relation to our minority non-controlling participation in the 'Ruta del Sol' toll concession project.

But first, allow me to address certain important aspects of the Colombian and Central American macro environment and to outline the main changes to the country's fiscal landscape presented to Congress by the Central Government in the form of a financing law which is similar to a tax reform, this new law is currently being debated in Congress.

On the Colombian macro environment, we expect that the 3Q GDP growth, to be

reported later today, will be similar to the previous quarter growth at 2.5%, for what we have seen already in the 4Q, we now expect that GDP growth for fiscal year 2018 will come in between 2.6% and 2.7%, if the trend continues we expect a better real GDP growth for 2019 at 3.25%.

Inflation on the last 12-month basis for September registered at 3.23% and October at 3.33%; however, we now expect inflation for 2018 of 3.3% with an upper bias given the recent foreign exchange volatility, for 2019 we are budgeting an inflation of 3.5% in absence of the impact of the fiscal reform. If the fiscal reform is passed, in its current version, we expect that inflation will pump-up by 100 to 150 basis points during 2019 returning to a 3.5% level in 2020.

We expect the Central Bank to keep its intervention rate at 4.25% for the remainder of this year, but in our base-case scenario for 2019 we also expect a more contractionary monetary policy approach in the form of three-rate hikes and in the year at 5%; therefore, on average rates will increase by 50 basis points next year. However, if the fiscal reform is passed as presented, the value-added tax increase will probably demand an additional hiking rate in order to keep inflation expectations within the Central Bank's band.

With regards to foreign exchange, we expect to see further volatility associated to the fluctuation of oil prices, if the price of oil continues to fall the Colombian peso depreciates, the current level does not still pose a threat to inflation, but if the trend continues, then the Central Bank will have yet

another reason to hike rates faster than expected.

The Much touted fiscal rule imposes a maximum fiscal deficit of 3.1% for 2018, which we believe will be met without problem and likewise for the 2019 goal of 2.4%, taking into account Ecopetrol's results for this year and the expected dividend distribution from this company to its shareholders next year.

Staying on the fiscal front, we have prepared and inserted a slide in our presentation outlining the most important aspects of the financing law currently under discussion in Congress. In essence, the government is trying to change the balance of the tax burdens in a way so that taxes shift more towards individuals and away from corporations. In summary, individuals will contribute more via equity taxes, higher personal taxes, less tax deductions and payment of value-added taxes charged on mortgage and services. Corporations will be taxed less via reduced corporate income taxes and new tax deductions such as the cost of financial transactions and the industry and commerce taxes. Partially offset by the elimination of overtax deductions in the new tax and dividends received by Colombian base corporations. We welcome the efforts of government to do so, but we expect tough discussions in the next few weeks, as the proposed mention of that will be very unpopular.

In Central America, we are specially watching the political and economic performances of two countries: Nicaragua and Costa Rica.

The good news is that Nicaragua despite of being in the midst of a well-known complex political situation that started back in April of

this year, has recently seen its economic environment achieve a certain level of stability. Although economic activity is still lower than that of last year's, several sectors including agriculture and consumer goods have begun to show signs of moderate growth. It must be noted that Nicaragua's assets account for less than 2% of our total consolidated assets.

Bank deposits which suffered significant losses in the early stages of the crisis are showing positive signs of stabilization, in our bank we have begun to see increases in our customers' balances.

Costa Rica's economy has slowed-down in recent months given the uncertainty generated by the fiscal imbalance. In addition, local currency recently experienced a 7.7% devaluation which has added pressure on the economy.

The fiscal issue in Costa Rica remains the main pressure factor in the economy. To address it, government is in the process of implementing a fiscal reform which includes new taxes, or changes to existing ones, and some government expenditure control. If fully implemented, the Central Bank's estimates that reform will reduce the fiscal deficit to 3.7% of GDP by 2022, and will enable the country to reverse its debt-growth trend. As of to date, the fiscal adjustment underwent and passed its first debate in Congress and is under study in the Constitutional Court, which is evaluating substantive and procedural issues. In case some problems are found with these issues, Government will be afforded a chance to amend the reform and pass it again for final debates.

Meanwhile, the Ministry of Finance have executed some actions such as short-term debt source, new debt issuances in local markets and refinancing debt maturities.

Next, and although Diego will run through the numbers once I'm done, allow me to highlight some certain strategic aspects of our 3Q results.

In an already very slow-growth scenario, we continue to favor minimum growth of our commercial loan portfolios while we deal with the quality of specific loans. In the meantime, we are focused on implementing pricing and loan structure strategies oriented towards the optimization of the profitability our lending practices, in other words, profitable growth and not just growth.

We view as positive the stability of our net interest margin, the strength of our banking fees, our fee income from credit cards and the fee income from our pension business.

Our cost-control initiatives and our digitalization efforts continue to show results as can be seen in both our fee expenses, which declined by 3% in the quarter and by more than 5% in year-to-date and in our operating expenses including non-cash items, which decreased by 0.9% in the quarter and have grown only 1.8% in year-to-date versus the same period in 2017.

Although cost-of-risk increased during the quarter, this is mostly due to the application of new macro parameters as required by IFRS 9 to our loan portfolios in Nicaragua and Costa Rica.

However, the largest new contributor to our bottom-line this quarter, is by far 'Corficolombiana' in the income it generated

in the two 4G concessions that it has started to build: 'Pacífico 1' and 'Chirajara-Fundadores'. Completion of the construction phase of these two projects is estimated by the end of the year 2023, the National Infrastructure Agency (ANI) signed two days ago, the go-ahead to initiate the construction of a third 4G project 'Villavicencio-Yopal' and therefore we will commence construction of that road in a week or two, we expect to complete it by the year 2024. The construction of a fourth project 'Mulaló-Loboguerrero' should commence in the third quarter of 2019 and be completed by the year 2025. 'Corficolombiana' is the sole shareholder in three of these projects and a 90% shareholder of the fourth.

The strong revenue generated by these concessions and those to come, especially during the time that it takes to build the roads is largely explained in the full adoption of IFRS 15. These accounting rule requires 'Corficolombiana' to differentiate the phases of the concession project namely in the construction phase and the operation phase. Each phase represents a different service provided to the contracting party, in this case the Colombian government. In fact, in the construction phase, the service provided is the building of the road while in the operating phase the service consists of operating collecting tolls and maintaining the road. Returns to the contractor during each phase must be proportionate to the risk incurred by such contractor. In essence, one could argue that the operating years relate to a quasi-risk-free business while most of the risk is incurred during the construction phase.

Before adopting IFRS 15, 'Corficolombiana' treated each 35-year concession project as

only one business, without distinguishing the risk assumed in the first five years of construction from those incurred during the other thirty years of operating the road.

In terms of net income, before adopting IFRS 15 the bulk of it came during the last operating years of each concession, reflecting something similar to a cash accounting treatment.

After IFRS 15, despite the fact that total returns of each concession project stayed the same, the recognition of returns accelerate during construction in line with the level of risk assumed, it is important to clarify that the timing of the cash received by the concessions does not change.

Upon the adoption of IFRS 15, COP\$ 330 billion pesos in retracted net income going back to the beginning of 2018, was recognized in 'Corficolombiana' during the third quarter. This amount positively impacted 'Grupo Aval's net income by COP\$ 125 billion pesos, this was a one-time adjustment to our net income for the year.

Additionally, during the third quarter recurrent net income of COP\$ 220 billion pesos was generated at the 'Corficolombiana' level, as a result of construction progress in the mentioned 4G projects, which represented recurrent net income of approximately COP\$ 88 billion pesos at the 'Grupo Aval' net income level. In summary, 4G projects added COP\$ 550 billion pesos to Corficolombiana's bottom-line which represented COP\$ 213 billion pesos of net income to 'Aval'. Out of the COP\$ 213 billion pesos, COP\$ 88 billion pesos is recurrent net income.

As the construction of the other two 4G projects get under way, and as the current ones pick-up steam, another boost will be given to Corficolombiana's and Aval's bottom lines. In fact, in our estimation 4G will add approximately COP\$ 115 billion pesos per month to Corficolombiana's net income during 2019 or approximately COP\$ 45 billion pesos at Grupo Aval's attributable net income per month or COP\$ 24 pesos per share in the year for 'Grupo Aval'.

On another note, it is important to note that our 2Q results showed slight changes in our net interest margin, cost-of-risk, and quality of the loan portfolio for the quarter but no change in our bottom line. These changes are consequence of KPMG's issuance after our 2Q results call of its practical guide to account and implement IFRS 9 into a resulting better understanding of how we should treat the provisioning expenses of stage 3 loans. We are confident that our current interpretation of IFRS 9, which is generating headaches to worldwide is now accurate.

With regards to our digitalization efforts, I would like to point out that our digital transformation continues to advance. In Central America, which is where our digitalization efforts of our group began, results are clear:

One of every three clients of BAC is digital. Our goal is to surpass the one-million digital clients before year-end and hope to grow this figure by 25% in 2019.

By the end of this year, we will be able to place more than one-hundred fifty thousand products through digital channels, which is 60% more than in 2017 with a combination of

new functionalities and intelligent targeted-marketing spending.

We have launched a service chatbot which only five months after its launch, it has processed more than one-hundred and twenty thousand sessions without human interaction.

The combination of applied analytics in digital collections has helped us achieved greater productivity in our contact centers, we have been able to process 22% more accounts with 14% less personnel.

These data points are just some of the examples we have to show for advances in digital, the true efficiency improvement has also come from an eight-hundred head count reduction in the last three years and by being able to grow a balance sheet without an increase in our physical footprint. Our focus is we will continue to serve our customers in the least costly manner and the most effective way.

In Colombia, we started our digitalization effort over a year ago through the creation of two digital labs and soon to merge into Aval's digital lab. Some results of this effort are as follows:

More than 25% of Banco de Bogota's savings accounts openings are now done digitally, of these openings 94% of our clients are new to the bank.

More than 25% of new credit cards at 'Banco de Bogotá' are acquired digitally, at a fraction of the cost of other channels.

More than 30% of new vehicles loans at 'Banco de Occidente' are now produced



through the digital platform launched last June.

We expect that in 2019, 40% of total credit cards placed in 'Banco de Occidente', 'Popular' and 'Villas' will be done digitally.

As in Central America, in Colombia we have combined our digitalization efforts with a migration of transactions in the reformatting of the branches. During the last eighteen months, we have closed about fifty 'Banco de Bogota' branches, close to 8% of its footprint, we are in the process of closing 16 'Banco Popular' branches, 7% of its footprint, we have closed thirteen 'Banco de Occidente' branches 6% of its footprint, and we have closed nine 'Banco AV Villas' branches, 3% of its footprint. We will continue these optimization efforts in 2019.

As I offered, now let me briefly address the antitrust charges:

On January 20th, 2017 the Superintendence of Industry and Commerce [SIC] initiated a non-public administrative proceeding to investigate whether any anticompetitive behavior had been conducted in the public bidding process for the awarding of concession contract No. 001 of 2010 for the construction of the 'Ruta del Sol' sector 2 toll road concession awarded to Concessionaire 'Ruta del Sol' CRDS for short, a company controlled by Odebrecht with a 62% stake in which 'Episol', a subsidiary of 'Corficolombiana', held a minority of 33%.

This administrative proceeding commenced primarily based on the admissions made by Odebrecht and Gabriel Garcia Morales, a recipient of Odebrecht's bribes, former Vice-minister of transportation, and then acting

manager of the National Institute of Concessions (INCO) a government agency later replaced by the National Infrastructure Agency.

On September 14, 2018, the SIC (Superintendence of Industry and Commerce) held a press conference in which it reported its decision to present charges for three alleged violations of the Colombian legal regime of free economic competition associated to Ruta del Sol Sector 2, against Odebrecht, members of their management, and Concesionaria Ruta del Sol S.A.S. Corficolombiana, Episol and members of their management were charged with two of these three violations and Grupo Aval and members of our management were charged with one violation. An employee of the World Bank through the IFC, and José Elías Melo, former president of Corficolombiana were also charged.

The alleged violations naming 'Grupo Aval' and its affiliates and their management are as follows:

First, collusive practices for which Odebrecht, members of their management, 'Corficolombiana', 'Episol', and Jose Elias Melo were charged.

Secondly, taking advantage of a conflict of interest, for which 'Grupo Aval', 'Corficolombiana', 'Episol', myself, Diego Solano, Gustavo Ramirez, Alejandro Sanchez, both VPs at 'Corficolombiana', Jose Elias Melo and an employee of the IFC were charged.

'Grupo Aval', 'Corficolombiana', 'Episol', as well as the members of our management charged by the SIC, have already contested these accusations laying out the initial legal



basis for their defense, as well as submitting and requesting documental and testimonial evidence in support of their defense.

We cannot predict how long this proceeding will last, even though we believe that the legal basis and evidence supporting our defense should achieve the dismissal of these charges, if we are not successful, our companies may face the payment of fines for up to the equivalent of approximately USD\$ 24.5 million dollars per charge and our employees may be responsible for fines about to the equivalent of approximately USD\$ 490,000 thousand dollars.

Moving on, allow me to share with you our general guidance for 2018:

Real GDP growth between 2.6% and 2.7%.

Inflation 3.3%.

Loan portfolio growth between 3% and 5%.

Net interest margin approximately 5.7%.

Cost-of-risk 2.1%, which could go up to 2.3% as we will most probably book additional provisions to bring 'Electricaribe' to a provision coverage of 100%, CRDS to a coverage of 25%, and 'SITP' to a combined coverage of 35% percent.

Opex growth 3.5% due to cost reduction initiatives, such as personnel cuts, branch reductions and other.

Income from non-financial associated with 4G, at the 'Corficolombiana' level we expect COP\$ 1.2 billion pesos from 4G in 2018, and COP\$ 1.3 billion pesos of net income during 2019. Of these numbers 'Grupo Aval' consolidates 38% percent.

Return on average equity 16% percent.

And lastly our expectations about 2019:

During 2019, I see a year in which Colombia's growth will speed up to 3.25%, in Central America somewhat decelerate to between 2% and 3% percent.

Our expectation is for our core assets to grow between 8% and 10% percent.

In our net interest margin, we see offsetting forces: on the one hand, an increase in interest rate scenario which should favor our corporate portfolio, and on the other hand a stronger competitive scenario which could force the yields to lower. In all, we believe that the competitive forces should weight more, and thus that the net interest margin will decline by ten basis points.

We expect the quality of our loans to improve, throughout 2019 and in turn the cost-of-risk we expect this ratio to move within the 1.9% to 2% percent range, this number includes an estimated additional provisioning of 15% for 'Ruta del Sol' to bring its coverage up to 40% percent, not because we believe that there is a lesser chance to recover our money, but because it is required as time passes and no new payments are received. If this situation changes, so will our estimation for additional provisions. Also, included in this cost-of-risk estimate, it is our intention to increase the coverage of 'SITP' related loans as follows: Tranzit to a 100%, Consorcio Express to 60%, and ETIB to 40% percent.

We expect our OPEX to grow at close to 8% percent, mainly as a consequence of our expected faster growth, and also due to the implementation of IFRS 16.

The return on equity for the year is expected at approximately 16.5% percent.

With that, I will pass this conference call to Diego and I thank you for your time

[Diego Solano Saravia,](#)  
[Chief Financial Officer](#)

Thank you Luis Carlos.

I will now move to the consolidated results of Grupo AVAL under IFRS.

As mentioned by Mr. Sarmiento, figures for the 2Q2018 have been adjusted with no impact on net income to better reflect the effect of IFRS 9 provisions on stage 3 loans. As a result, higher net interest margin, cost-of-risk and PDLs are recorded for the 2Q2018 as previously reported.

Moving to our results for this quarter, five elements drove our performance.

First, a still low momentum of the corporate loan portfolio in Colombia.

Second, stability in the quality of our loan portfolio in Colombia and some deterioration in Central America.

Third, stable NIM,

Fourth, continuing cost control efforts,

And fifth, a strong contribution of our non-financial activities reflecting the impact of IFRS 15 and our increasingly important 4G road concession construction activity in 'Corficolombiana'.

Starting on page 9, assets grew 3% during the quarter, driven by an increase in cash and cash equivalents, Fixed income investments and the value of our concession arrangement rights. Central America which weights close to 29% of our book, saw a 0.5% contraction in

dollar terms driven by the political cycle in Nicaragua. Nicaragua accounts for less than 2% of our total assets.

Moving to page 10, loans excluding repos grew at a modest 0.9% during the quarter. Commercial loans continue to drive the soft growth dynamics in Colombia. This is partially compensated by a stronger performance of our consumer portfolio supported in a positive trend in its quality. We will continue to focus on profitable growth and expect momentum to pick-up through 2019.

Our Colombian consumer and mortgage business continued to be dynamic, expanding 2.4% at 4.3% during the quarter, and 8.3% and 20.1% percent respectively over the 12-month period. In contrast, our Colombian corporate portfolio contracted by 0.7% during the quarter and by 0.8% over the year.

Central America grew 0.5% in dollar terms during the quarter, accumulating 5.5% over the last 12 months. This 12-month performance was driven by a 7.2% contraction in Nicaragua and a 6.8% expansion in the rest of the region.

We expect 2018 loan growth to be in the 3% to 5% area, and to pick-up 8% to 10% percent during 2019.

On pages 11 and 12 we present several loan portfolio quality ratios.

We experienced a slight increase in our PDL ratios. A deterioration in Central America and a contraction of our Colombian corporate book drove this behavior. Deterioration in Central America came mainly from Nicaragua and Costa Rica as described by Luis Carlos, due to the political volatility and some corporate clients in the region. In contrast,

the improvement in quality of our consumer portfolio in Colombia, continues to consolidate with faster loan ratios improving 27 basis points to 5.5% on a 30-days basis and 16 basis points to 3.4% on a 90-day basis.

Our PDL coverage remains stable while our cost of risk deteriorated 37 basis points due to a 72 basis points deterioration in Central America.

In spite of this slight deterioration in Cost of risk, we continue to see an improvement in new PDLs formation, especially in our Colombian operation. Relative to the previous quarter, our new PDL formation in Colombia improved 12% to COP\$ 656 billion pesos on a 30-day basis, and 28% to COP\$ 664 billion pesos on a 90-day basis. Our overall new PDL formation improved by 6% on a 30-day basis and 23% on a 90-day basis.

With regards to coverage ratios of the three corporate cases that we have been following for the last conference calls, 'Electricaribe' and 'RDS' were stable at 80% and 13% percent respectively while our coverage for 'SITP' companies reached 29% up from 21% a quarter earlier. The coverages for 'SITP' companies were 67%, 35% and 13% for 'Tranzit' 'Consortio Express' and 'ETIB' respectively, as described by Luis Carlos we expect to increase our coverage ratios for 'CRDS' 'Electricaribe' and some 'SITP' companies by year-end. These additional provisions could imply approximately 20 basis points additional to our cost-of-risk this year.

We expect 2018 cost-of-risk net of recoveries to be in the 2.3% area, including these additional twenty basis points. For next year, we expect our cost-of-risk to be in the 2% area.

On page 13, we present funding and deposits evolution. Funding dynamics were consistent with loan growth. Our funding structure remains relatively stable with deposits representing 76% of total funding. In addition, our liquidity position slightly improved with our deposits to net-loan ratio reaching 97%, and our cash-to-deposits ratio at 16%.

Deposits grew by 0.8% during the quarter accumulating 4.3% over the last twelve months. Colombia and Central America grew at similar paces during the quarter. Over the twelve-month period, Central America was more dynamic than Colombia growing a 7.9% in dollar terms, while Colombia grew at 2.4% percent.

We expect deposits to continue growing at a similar pace, for loan portfolio during remainder of 2018 and 2019.

On page 14, we present the evolution of our total capitalization, our attributable shareholders' equity and the capital adequacy ratio of our banks.

Our total equity grew 10.4% while our attributable equity grew 6.7% over the quarter, mainly driven by earnings during the period. In addition, the equity issues in 'Corficolombiana' contributed close to a COP\$ trillion pesos to capitalization and COP\$ 138 billion pesos to our attributable shareholders' equity.

All of our banks showed appropriate Tier 1 and total solvency ratios.

On pages 15 and 16 we present our yield on loans, cost of funds, spreads and net interest margins.

Interest rates and margins were stable relative to the previous quarter, and the stability of the Central Bank's intervention rate experienced throughout the recent months. The average yield on loans cost of funds spreads were substantially stable.

Moving forward, through 2019 we expect an expansion of new corporate loans as the Central Bank starts to raise its rates, while our consumer portfolio we see increased pricing competition as the improvement in quality of the consumer loans consolidates into a more dynamic growth increases the share of newly priced loans in our mix.

We expect full year 2018 NIM to be in the 5.7% area slightly higher as previously guided, and in the 5.6% area for 2019.

On page 17 we present net fees and other income. A substantially better performance of the infrastructure sector, will step income from the non-financial sector during the quarter. This positive performance reflects the application of IFRS 15 into the progress made in the new 4G concessions and our Private-Public initiative toll road concessions.

Relative to the previous methodologies, IFRS 15 results in a higher recognition of profits during the construction phase offset by lower profits during the operation and maintenance phase. 'Corficolombiana' expects to benefit over the following five to six years from the recognition of its construction activity at its currently contracted concessions.

IFRS 15 requires the concessionaire to recognize separate profits and losses from different obligations under the contract. As a result, profits from construction are fully recognized throughout the construction

phase. In contrast, the previous methodology required that construction activity profits were distributed throughout the life of the concession.

During this quarter 'Corficolombiana' booked an after-tax net income of COP\$ 550 billion pesos or COP\$ 0.8 trillion Colombian pesos pretax towards its new toll road concessions, of which approximately to COP\$ 213 billion pesos or 38% are attributable to 'Grupo Aval' shareholders.

Income from this source was particularly high during the quarter given that it incorporates 9 months of income from two of our concessions.

In absence of the income from previous quarters, after tax net income from these concessions would have been COP\$ 220 billion pesos, of which approximately COP\$ 88 billion pesos were attributable to Aval's shareholders.

We expect contribution of our toll road concessions to increase as the 'Villavicencio-Yopal' concession, which reached its construction phase initiation this week, starts to contribute during this quarter.

Finally, in other sectors of the non-financial activity a better performance of our operation in energy and gas and hotels also contributed to better results of our non-financial sectors in the quarter.

Also, on this page, gross fee income dynamics were consistent with the balance sheet performance decreasing COP\$ 10 billion pesos or 0.7% during the quarter, mainly driven by the contraction of the banking fees in Colombia.

This was offset by other operating income that increased COP\$ 23 billion pesos driven by a stronger contribution of the FX and hedging activity and a mixed performance of other line items.

On page 18 we present some efficiency ratios.

We continue to emphasize our operation efficiency initiatives both in Colombia and in Central America with positive results throughout most of our banking subsidiaries. The progress of our digital efforts and cost control initiatives throughout our subsidiaries have been key drivers of this progress. Personnel and administrative expenses decreased by 1.6% during the quarter and increased 1.7% when compared to a year earlier. Initiatives behind these results included head-count reductions in certain areas, formatting and closure of branches, migration of transactions to ATM and digital channels.

As a result, our efficiency ratio measured as operating expense to average assets a 3.5% for 3Q2018 improved 12 basis points from the previous quarter. Central America and Colombia reported ratios of 3.1% and 4.4% respectively for 3Q2018.

Our efficiency ratio measured as an operating expense to total income showed an improvement of 700 basis points to 39%, compared to the previous quarter, and 770 basis points through the same quarter a year earlier. Our efficiency ratio was positively impacted by the increase in income from our non-financial sector described earlier. Central America and Colombia reported ratios of 35% and 49% respectively for 3Q18.

In spite of the low asset growth that we have experienced so far, we expect to maintain our cost to assets basis at 3.5% for the full year 2018 and a slight improvement in 2019.

Finally, on page 19 we present our net income and profitability ratios.

Our total net income for the 3Q18 was COP\$ 783 billion pesos, or \$35 pesos per share.

Our return on average assets was 2.4% and our return on average equity was 19.1%.

In the absence from the income of non-financial sector from previous quarter, our total net income for 3Q2018 would have been COP\$ 658 billion pesos or COP\$ 29 pesos per share, our return on average assets would have been 1.9% and our return on average equity would have been 16.1% percent.

Before we move into questions and answers, I will now summarize our general guidance for 2018 and 2019:

We expect loan growth to be in the 3% to 5% percent area in 2018 and 8% to 10% area for 2019.

We expect our cost-of-risk, net up recoveries to be in the 2.3% area in 2018 including 20 basis points from the large corporate cases mentioned before and improve to 2% area in 2019.

We expect full year net interest margin to be in the 5.7% area in 2018 and in the 5.6% area for 2019.

Regarding efficiency ratios, we expect cost to assets to be in the 3.5% area in 2018 and slightly improve through next year.

Finally, we expect a return on equity to be in the 16% area this year and 16.5% area next year.

We are now available to address your questions.

## Q&A

**Operator:** Thank you. We will now begin the Q's & A's session. If you have a question, please press \* and 1 on your touchtone phone. Please, limit yourself to one question and can be queued for follow up question. If you wish to be removed from the queue please press the # or the hash key, if you are using a speaker phone you may need to pick up the handset first, before pressing the numbers. Once again, if you have a question please press \* and 1 on your touchtone phone. Standing by for question...

Our first question comes from Andrés Soto from Santander, please go ahead:

**Andrés Soto:** Thank you for the presentation. My question is regarding your loan-growth guidance in 2019, can you please break-down this 8% to 10% amongst your preferred loan segments, I'm curious to hear your views about how sensitive is this outlook to the implementation of the tax reform next year. Thank you.

**Diego Solano:** Andrés, regarding growth as you might have seen in our numbers, we expect the growth for the corporate segment to continue to be very low, these means low single digits, while our consumer and mortgage performance have been closer to 10% in an area where we believe our numbers will continue to perform and eventually

accelerate at some point either later this year or throughout next year. So, in summary basically we are expecting to see a continuation of what we have seen over the past few quarters.

Regarding the eventual tax reform, it is tough to say at this point given that there is a number of issues still to be discussed, obviously if you take money away from the consumers' pockets there could be some expectation of pressure on consumer growth, but I would prefer to wait to see the discussion on the tax reform before we give any guidance there.

**Operator:** Thank you. Our next question comes from Yuri Fernandes from J.P. Morgan, please go ahead.

**Yuri Fernandes:** Thank you gentlemen I had a question on these IFRS 15 changes and specifically the effect for 'Banco de Bogota'. My question is this accounting change held from the capitalization of 'Banco de Bogota', how this can affect capital ratios because looking here, I saw some decline on the capitalization rate for 'Banco de Bogota' and it was not clear for me if that may help on the potential base implementation for your subsidiaries. Thank you.

**Tatiana Uribe:** Hi Yuri, this is Tatiana. The impact on 'Banco de Bogota's' current capitalization level is actually negative, because under current capital regulations or standards, the full value of 'Corficolombiana' investment is deducted from core equity Tier 1, so actually that is one of the points that we want to see changed going into Basel 3, because the full deduction is not even Basel 8, so to answer your question, we currently affect 'Banco de Bogota's' capital position.



**Luis Carlos Sarmiento:** It does obviously have a positive impact coming from Bogota's participation in 'Corficolombiana' thru a 'método de participación - participation methodology', meaning obviously as long as 'Corficolombiana' yields more net income, 'Banco de Bogota' will book more net income itself by 38%, no...it's less, about 32% of what 'Corficolombiana' yields us in net income, so it has a positive effect in net income, and then as Tatiana was saying, the bigger the investment in 'Corficolombiana' becomes in 'Banco de Bogota's balance sheet, the less Tier 1 ratio will produce because it's got to be deducted off. We are, as Tatiana says, in conversations with the Superintendence of Finance to try to change that point, specifically.

**Operator:** Our next question comes from Rodrigo Sánchez from 'Davivienda Corredores', please go ahead

**Rodrigo Sánchez:** Good morning, thank you for taking my question. Construing your presence in the U.S. through the ADR, I would like to know if at some point, any institution such as the SEC or Department of Justice have requested any information regarding the investigation in Colombia regarding the SIC

**Luis Carlos Sarmiento:** Oh Great, thank you for your question. The answer is NO

**Operator:** Our next question comes from Carlos Gómez from HSBC, please go ahead

**Carlos Gómez:** I would like to clarify a bit further the changes you have made regarding IFRS, so you have restated the second quarter figures, has there been any impact on equity compared to what you have reported before?

**Diego Solano:** No, not at all...actually what we have done is change that does not affect equity, nor it affects earnings, it's a presentation difference basically where the difference lays are in those net numbers, are the same gross numbers as presented changed, so you end up exactly in the same earnings, and you end up exactly in the same equity, but when you present your P&L numbers are opened up in a different manner

**Operator:** Our next question comes from Sebastián Gallego from 'Credicorp Capital', please go ahead

**Sebastián Gallego:** Hi, good morning, thanks for the presentation. I have two questions, the first one regarding your guidance on ROE for next year, should we expect that to be a recurring ROE or should we expect that to be also influenced by the accounting treatment of 'Corficolombiana' that you mentioned and the second question is regarding 'CRDS 2', I'd like to have a sense of your base-case scenario in terms of timing and potential additional investigation and what could be the outcome, particularly regarding the payments that the banks are still awaiting, thank you.

**Luis Carlos Sarmiento:** OK, let me address both questions. In terms of the ROE for next year no, on the contrary, we expect especially given two issues, one: that the provisions that we're booking in addition to normal provisions. Or three issues, secondly, we are expecting the quality of our loan portfolios to become better and thirdly, the positive impact that we'll have based on this fiscal reform, if it passes, the answer is no, on the contrary we will expect ROE to get better in the following years. It's hard to say up to what it will come, but you know...it wouldn't be too



hard to predict a pickup of about 100 to 200 hundred basis points, but for now we are confident that with next year's guidance and as we know a tax reform will be more confident on following years' ROE expectations.

With regards to 'CRDS', I think the most important thing that is happening is that the arbitration tribunal is back with three judges. I don't know how public this is... this is public information but I don't know how much you're aware of it, but the third judge in the arbitration tribunal passed away, so there's a new judge that just accepted the post. He has requested that he needs another six months, and it's one of the reasons that this thing is getting delayed, and so we expect that we'll have a pronouncement by say May of next year. In the meantime, because that pronouncement coming out of the arbitration tribunal will be final with respect to what the liquidation value of the contract is. That's very important because then we'll know with certainty exactly how much money will be paid to the banks, but in the meantime, we are fairly confident that a second payment in addition to the payment made back in December of 2017 to the banking system, fairly confident that a second payment will be made. It's tough to know the amount of that payment, but the reason that we are pretty confident that a second payment will be made is because there is some money sitting in bank accounts relating to monies that have already been transferred from the government to a trust account in relation to that completed construction of 'CRDS' which just hasn't been disbursed and I think that we have enough push from the government to get it disbursed.

So, to answer your question, the arbitration tribunal is very important with regards to the monies that are going to be paid to the banks, secondly we expect a second payment to be made between now and May of June of next year, and thirdly we expect it at the latest May or June of next year we'll have the final payment to be made.

**Operator:** Our next question comes from Jason Mollin from Scotiabank, please go ahead

**Jason Mollin:** Hi, my question is related to accounting changes for IFRS we now see in IFRS 9 and 15. What should we expect going forward, are there additional IFRS that you are discussing, implementing or how should we take that. Clearly it seems that just in this quarter you stripped out the retroactive numbers, that the numbers are pretty comparable, but how should we think about earnings and equity going forward from further changes, thank you.

**Diego Solano:** These changes are something that actually has happened when we migrated to IFRS that we were not accustomed to see when we were looking at our reconciliation to U.S. GAAP and it is that IFRS constantly comes around with numerals that do affect our numbers. At this point we are aware that, not only for us but around the world, there is a new IFRS rules coming around, for example IFRS 16, that changes the way that some leases are taken care of, that might have some impact, we are not foreseeing any substantial impact on our figures at this point, but it's coming around.

IFRS 9 is also coming around, not only for us but for the rest of the world, and I'd say in this case IFRS 15 has been relevant for us because

it came at a time where we were starting a bunch of new roads where construction was being deployed and it had a particularly high impact for us. That's why in this case we went into detail in to trying to understand how should we be dealing with these rules and try to be as transparent as possible, therefore showing what part of our revenue from this quarter came from previous quarters, what part we believed was something that should be recurrent moving into the future and actually gave you a time frame of what the construction period of these toll roads that we have contracted at this point will be, as I mentioned in 5 to 6 years, depends very much on our ability to generate new businesses in the future to understand if beyond those 5 years if we will continue to have this kind of benefit.

Regarding Basel III these changes do not have or these accounting changes do not have a substantial impact on technical capitalization beyond what we have disclosed in the past. With Basel III coming into Colombia, as we have mentioned in our past calls we do expect to see some impact: positive on most of our banks, close to neutral in 'Banco de Bogota' and that's about what we can say at this point.

**Luis Carlos Sarmiento:** Obviously as we have estimations of specifically on IFRS 16 on the way that we have to book specially leasing contracts for our real-estate or our branches going forward we will pass that amount to the market.

**Operator:** Thank you, we have no further question at this time. I would like to turn the call back over to Mr. Sarmiento for closing remarks.

[Luis Carlos Sarmiento Gutiérrez](#)

[Chief Executive Officer](#)

Ok, Jessie thank you very much.

I'd like to thank everybody who was on the call, and obviously we are always open to additional questions that did not come up and we'll be happy to answer those and if not, until next call and if anything happens in the meantime, we'll let you know and thank you very much.

**Operator:** Thank you ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.

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