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Banking GAAP

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CORPORATE PARTICIPANTS

Luis Carlos Sarmiento Gutierrez *Grupo Aval - CEO*

Diego Solano *Grupo Aval - CFO*

CONFERENCE CALL PARTICIPANTS

Juan Dominguez - *Analyst*

Nicolas Noranda - *Analyst*

Mauricio Resto - *Analyst*

Daniel Goriella - *Analyst*

Phillip Travis - *Analyst*

PRESENTATION

Operator

Good day ladies and gentlemen, and welcome to the Grupo Aval Third Quarter 2013 Consolidated Results Under Colombian Banking GAAP Conference Call. My name is Adriana and I will be your operator for today's call.

(Operator Instructions)

Quarterly results included in this webcast have not been audited, however, they are prepared in accordance to the regulations of the Superintendency of Finance for financial institutes and generally accepted accounting principles for banks to operate in Colombia, also known as the Colombian Banking GAAP, which differs in certain significant respects from the US GAAP yearly audited consolidated financial statements included in our Form 20-F filed to the SEC provided a description of the principle differences between Colombian Banking GAAP and the US GAAP.

Grupo Aval as an issuer of securities in Colombia is subject to the control of this Superintendency of Finance. Although we are not a financial institution, we present our consolidated financial statements under Colombian Banking GAAP and as quarterly report because we believe that presentation on the basis most appropriately reflects our activities as a holding company of the group of banks and under financial institutions.

This webcast may include forward-looking statements, which actual results may vary from those stated herein as a consequence of changes and general economic business conditions, changes in interest and currency rates and other risk factors as evident in our Form F -- excuse me, 20-F available in the SEC webpage.

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When applicable, we will refer to billions as thousands of millions. With us today is Mr. Luis Carlos Sarmiento Gutierrez, Chief Executive Officer of Grupo Aval; and Mr. Diego Solano, Chief Financial Officer of Grupo Aval; and Tatiana Uribe, Financial Planning and Investor Relations Officer of Grupo Aval.

I would now like to turn the call over to Mr. Luis Carlos Sarmiento Gutierrez. Mr. Sarmiento Gutierrez, you may begin.



Luis Carlos Sarmiento Gutierrez - Grupo Aval - CEO

Thank you very much. And thank you very much all for joining our call. My name is Luis Carlos Sarmiento. And I would like to take five minutes of your time to take up the presentation with the main highlights of this quarter. Then, as usual, we will proceed with a brief update of the Colombian macro environment, and finally, we will run through the main results of our balance sheet and income statement for the quarter end of September 30th.

In general, this quarter was one of very strong results for Grupo Aval. Specifically our net income for the period, so COP103 billion grew by 27% verses last year's third quarter. Our return on average equity for the quarter was 24 and 4% and 19% when annualizing the nine month period ending September 30th.

Our return on average assets for the quarter was 1.9% and 2.1% when annualizing it for the nine month period ending September 30th. These profitability ratios were mainly a consequence of first, an 11.6% year-on-year growth in our balance sheet to COP143 million with net loans and financials leases growing by 14.2% to COP85 trillion during the same period.

Secondly, a 5.9% net interest margin for the period, 10 basis points lower than the previous quarter. Our accumulated net interest margin for the first nine months of this year was 6.3% verses 6.4% for the nine month period ending September 30, 2012.

Last, but not least, a 21% increase in our operational margin and a controlled increase in operating expenses. In fact, our efficiency ratio improved from 53.3% in the second quarter of 2013 to 51.1% in the third quarter of 2013 as the brunt of non-recurrent expenses associated with our (inaudible) account consolidation was mostly felt in previous quarters.

At the same time, our loan portfolio quality ratios remains strong as evidenced by a ratio of provision expense to average loans, which improved to 1.4% in the third quarter of 2013 verses 1.7% in the previous quarter. While the allowance for non-performing loans improved slightly to 195% as of September 30, 2013 verses 194% one year before and that (inaudible) 38 and over as of September 30, 2013 also remains stable at 2.5%, 10 basis points higher than a year before.

There are other relevant events that I would want to mention in this call. Mainly as some of you may already know we have announced two equity offerings, first, Banco de Bogota's common share issuance of approximately \$500 million. And secondly, Grupo Aval common share issuance of approximately \$1.3 billion. Both equity offerings are directed to current ordinary shareholders.

(Inaudible) the best rational is to strengthen its capital structure in the wake of the two acquisitions that it announced a few months ago. Grupo Reformador in Guatemala and BBVA in Panama. As you may also recall, Grupo Reformador will be purchased directly by Banco de Bogota's subsidiary, [Banquero Matic] and BBVA Panama will be acquired by another Banco de Bogota's subsidiary, LPP, which is that holding company.

Banco de Bogota will capitalize LPP in \$500 million using the proceeds from this offering. Grupo Aval's rational can be summarized in three objectives: one, strengthening of our capital structure; two, increasing our profitability by the retirement of about \$800 million in (local debt) outstanding; and three, replenishing the liquidity that we will use to capitalize Banco de Bogota, although the price per share of (inaudible) issues has not been announced, we expect that it will be at a very slight discount verses the average trading price of the past six months.

Moving on, the approval processes for the two acquisitions in Central America are progressing without any delays. We expect to close both acquisitions in the next month or so. Finally, we expect the merger Porvenir and Horizonte to be affective before January 1, 2014.

And with that, I would like to pass this on to Diego Solano who will describe in more detail our highlights and the rest of our results. Thank you very much.

Diego Solano - Grupo Aval - CFO

Thank you Carlos. Now starting on page four, you will see some of the key metrics of the economy that will affect our business. At the top of the page you'll find GDP growth as projected by the IMF and the National Statistics Department of Colombia. As the year has progressed, the growth expectation both for Colombia and for the rest of the world have been brought down with GDP growth expectations for Colombia at 3.7% in real terms and at 2.9% for the rest of the world.

In the middle of the page you can see interest rates and DTF. It's a central bank rate, which is determined on the prices of the rest of the rates in Colombia has remained at this virtually low levels at 3.25% for the past two quarters down from 5.42% for the third quarter of 2012. DTF, which is the rate of which most of our corporate loans are priced, it estimated that 4% as in the second quarter of 2013 down from 5.4% a year ago.

At the bottom of the page you can see how dollar has moved in Colombia. We have had depreciation of -- depreciation of the peso, 0.7% over the past quarter and 6.3% over the past 12 months.

Moving to page 5, you will see our assets. Our assets as Carlos mentioned before, have grown 11.6% over the past 12 months up to COP139 trillion. For the three month period ending on September, they have 0.9%.

At the bottom of the page you can see the breakdown of our assets. The structure of our assets remains relatively steady with loans at 61%, investments at 19.3%, and other assets at 19.7%. 8% of our assets classified on the other assets are cash. Regarding where our assets are located, 82% of our assets come from our Colombian operation.

Now moving to page 6 you're going to find our loans, our gross loans have grown at 14.3% over the past 12 months to COP88 trillion and have grown 3.1% over the last nine months. At the bottom of the page you'll see the breakdown of our loans. What you can observe is that there has been an increase in the weight of consumer and mortgage loans. As we work towards achieving our natural market share on those businesses. Mortgages have grown at 26%. Consumer loans have grown to 15%.

Moving to page 7, you will see some charts regarding loan portfolio quality. Quality overall has been stable. Some changes in PDLs. PDLs have deteriorated 10 basis points, PDL, 38 plus, NPLs have remained flat at 1.7%.

Moving to top right of the chart, (inaudible) with a stabilization in credit quality, lower provision expenses has returned to normal. Loan provision expenses compared to average loans count at 1.4% down from 1.7% for the previous quarter. The bottom right of the page you can see the coverage of our past loan and NPLs.

They remain stable at appropriate levels at 1.95% for NPLs, 1.32% for PDLs and 3.3 as percentage of total loans. At the left, you will find charge offs as percentage of NPLs. That's found at 0.7 times.

Moving to page 8, the loan portfolio quality has further detail on the different categories of debt. Consumer loans have improved in the quality as mortgages have done, with consumer loans at 4.2% down from 4.4% and mortgages at 2.8% down from 3.0%. There has been a slight deterioration on commercial loans of 0.1% and financial leases up to 3.7% given specific transactions. I regret I believe I'm a page -- I have a one page difference with the document you're looking at.

Turning to the next page, you're going to find funding statistics at the left -- top left of the page you will see total funding. Total funding has grown at 12.1% up to COP117 trillion, 0.4% during the quarter, as profits continue to (inaudible) funding standing at 76%. To the right you will find detail on deposits, our deposit mix continues to be stable. And as in the past, savings and checking accounts represent most of our deposits standing at 67% for the third quarter of this year.

Deposits have grown 16.7% over the past 12 months. And they have decreased 0.6% during this quarter. Moving to the bottom of the page, deposits of net loans continue to be over 100% standing at 104% as of third quarter.



Next page you're going to find some charts on capitalization. At the top left you'll find the attributable equity plus minority interest called total equity has grown 9.5% for the past 12 months. To the right you're going to see our attributable shareholders equity, which has grown at 10.2% to COP9 trillion as third quarter 2013.

Equity plus minority interest as a percentage of our assets stands close to 11%. At the bottom of the page you're going to find capital equity ratio for our banks. You have to bear in mind that starting August 2013, the new rules on capitalization have been affective in Colombia. As previously mentioned, the main affect of our banks comes from changes in the way minority interest is accounted for.

And in addition, goodwill from transactions completed after August 2012 have begun to be deducted. All of the capitalization ratios for our banks are appropriate.

Moving to next page, you're going to find the net interest margin. Our net interest margin stands at 5.9% for this quarter with a net interest margin on loans down to 7.4% from seven basis points from -- down from the previous quarter due to a contraction in the (inaudible) loans, which was up 35 basis points.

At the bottom of the page of this chart you're going to see the net interest margins on investments. It stands at 1% at historically low levels.

Moving to the next page, you're going to see the net fees and other operating income for our operations. Net fees at top left of the chart have grown close to 22% up to COP716 billion. Primarily the (inaudible) pension plans, banking services, and credit cards. The fee breakdown is at the top right of the page. Commissions from baking services stand at 47%, pension plans at 21% of our largest sources of (inaudible).

At the bottom of the page you can see the other operating income. Other operating income has grown 85% as compared to the same period for 2012. The main driver of this growth has been given an income, dividend income at (inaudible) Columbiana. You have to bear in mind that we have a substantial minority interest in (inaudible) Columbiana. Only 40%, 40%, of the income of (inaudible) Columbiana ends up in our income at the (inaudible).

Moving to the next page, our efficiency has improved as we have expected last quarter as the non-recurring effect of Horizonte that we have during the second quarter fades away. Our operating expenses as a percentage of operating income stands at 51% down from close to 54% for the same quarter last year. Operating expense as a percentage of average assets is at the same level as it was a year ago at 4.1%.

Finally, in the last page, in summary as a result of what Mr. Sarmiento mentioned on the previous pages, our net income has grown 27% when compared to third quarter 2012, and 22% as compared to our previous quarter. Return on assets for the quarter was 1.9%, 2.1% if you're looking at the nine months ended on September 30th. Return on equities down at 20.4% for this quarter, 19% for the nine months ended as of September.

And that is the presentation. Now we can open it to questions.

QUESTIONS AND ANSWERS

Operator

Okay. Thank you. We will now begin the question and answer session. Please be aware that we will limit one question per person. (Operator Instructions). And our first question comes from [Juan Dominguez]. Juan, go ahead.

Juan Dominguez -- Analyst

Good day. And thanks for hosting this call. I have a couple of questions. First, I wonder if you could give us some guidance on the reason of the quality decrease on pension management fees as shown in the release. Those fees decreased 21% on a quarterly basis. And if you could give us some guidance on what could we expect for coming quarters on that line?



And second, I wonder if you can give us a guidance on the Tier I ratio, the 2013 (inaudible) to one ration of Banco de Bogota once both inceptions are consolidated and if they can -- obviously the capital increase.

Diego Solano - Grupo Aval - CFO

Okay. I will take the pension question first regarding the decrease in pension management. In our last call we explained that we have an accounting affect starting to consolidate what we saw there in our figures. We started consolidating Horizonte during our second quarter. However, under Colombian Banking GAAP, except if you have a special authorization from the Superintendency, but will you account for mergers.

If you take the full year of income and expense, and you deduct as a [period] that if it's not on the company as another expense. As a consequence, our second quarter has number affected by this merger that fade away during our third quarter. A more clear comparison if you take our quarter, our first quarter of 2013 and compare it to the same quarter of 2012 where you didn't have that affect and you can observe the kind of growth that we have had consequence of growth our third business plus the new acquisition.

Moving forward, we should go back to the credit we previously had before the acquisition of Horizonte, a growth in our pension fund income. There are no major changes in the current business environment for pension funds. That takes care of your first two questions.

Now regarding Tier I for Banco de Bogota, if you start from the numbers that we have in this document as of September and adjust for the transactions that will be completed including the capitalization, you would end up in the mid seven's for Tier I and the mid 10's for total capitalization. By year-end, given that in addition to these transactions, we will be having income from operations that should be standing somewhere around -- Tier I of around 8% in total capitalization of around 11%.

Operator

And our next question comes from [Nicolas Noranda]. Go right ahead.

Nicolas Noranda - - Analyst

Good afternoon and thank you for the conference call. My question is regarding Banco Popular business. I wanted to know what is the strategy going forward to make the loan portfolio reactivate. And we all know that the profitability of the bank is very high. But I was wondering what are the strategies to make the interest income grow again?

Diego Solano - Grupo Aval - CFO

Okay. Regarding Banco Popular, Banco Popular is very concentrated in table lending. As the quality of the consumer lending portfolios of competitor banks decreased and deteriorated in quality. Competition (inaudible), table lending increased substantially. As a consequence, given the concentration of Banco Popular, they suffered in their ability to grow given that they have decreased in this business.

We are currently looking at Banco Popular. There is no strategy that we can make public at this time. But the low growth is something that has obviously caught our attention over the past year. And we're working on seeking lines of growth for the bank.

Operator

And our next question comes from [Mauricio Resto]. Go right ahead.

Mauricio Resto - - Analyst

Hi, guys. Thanks for the call. Two questions, the first one, can you give us some color on the movements in deposits during the quarter where your periods increased it's deposit base while you decreased around 0.6%. And the second one is how do you see the [name] of loans evolving in the next couple of quarters? Thank you.

Diego Solano - Grupo Aval - CFO

Okay. Very good questions. Regarding the movement in deposits, first two issues you have to bear in mind when looking at the way deposits have evolved for some of the higher quality banks in Columbia. (Inaudible) we had substantial volatility of the government loan, or the government bond market and general (inaudible) market around the world. As a consequence we profited from some of the investors in this kind of paper moving to cash. And Banco de Bogota was one of the banks which got most of (inaudible) given the high quality of the bank.

So the decrease in the banks when compared to June has to do with a substantial increase that we had in deposits after the volatility of the bond market started. And given that that volatility has partially gone away, numbers have returned to normal.

In addition, when you compare our figures to last year to last September, last September we had issued the bond, the second bond of Grupo Aval, which generate substantial liquidity that was deposited, meaning in Banco de Bogota, most of the liquidity has already been taken out of Banco Aval so you can pay cash as a pay for normal what you're looking at at this time.

Regarding your second question on (inaudible) and loans, (inaudible) loans are erupting in a number of (inaudible) overall in Colombia has been affected by the low interest rate environment. The interest rate environment that's at 3.25% is historically low given that inflation in Colombia should be putting up to around 3%. And neutral central bank rates should be somewhere around 1.5%. So when you take those two components you should be looking at more 4.5% when we're back to normal.

Banks have substantial issues with their income, some of them are competitors. And that has made them much more aggressive in the lending side. As the process of repricings of loans fixed in, we have suffered third quarter from the affect of this competition in some of your near quarters. Moving forward, we expect to see an environment of higher interest rates. And it very much depends on how the federal government increases it's rate.

I will remind that around 20% of our total funding, 25% of our deposits are zero cost funds or close to zero cost funds. So our elasticity to the changes (inaudible) in the rate environment of our -- are around 20 basis points for every percentage point that the central banks moves.

In that line of thought, as interest returns to normal, we would expect to see an overall pickup in net interest margin. In particular regarding the loans, net interest margins as banks go back to more normal balance sheets and where banks (inaudible) that to investments. Some of this competition should return to more normal levels. And the other loans should pick up.

Operator

And your next question comes from [Daniel Goriella]. Go right ahead.

Daniel Goriella - - Analyst

Hi. Good morning. Thanks for the presentation. I just had one question actually. We saw during this quarter an extraordinary dividend income coming from (inaudible) Columbian. I would like to know if you guys could you please share with us what portion of this dividend income is recurrent and what will have been the impact on both ROE and efficiency ratio, if we will have this cleared this one time here? Thank you.



Diego Solano - *Grupo Aval - CFO*

Okay. Yes. The way you have to look at dividend income here is there's a piece that is due to seasonality and there's also a piece that is non-recurrent. From these close to 130 billion that you see here, that could be around COP50 billion that will be non-recurrent.

As the rest of these would be more seasonable, most of the seasonable comes from (inaudible). (Inaudible) is an investment in which during the last year, or the past year, we increased substantially our participation, and therefore, our participation in guiding management in the process of running the company.

We have been able to increase income as (inaudible) level. In addition, the dividend payout ratios that (inaudible) was having were under what (inaudible) should be having. So we have an increase due to this fact. I mentioned in the presentation that at the (inaudible) Columbian level, only 40% of -- or rather only 40% of the income of (inaudible) Columbian ends up at the (inaudible) level. So out of the COP18 trillion, what would be minority interest would be 60% of those.

Operator

And our next --

Diego Solano - *Grupo Aval - CFO*

I think I didn't answer your -- you had a secondary question of how should our return on equity look if adjusted for this dividend. Bear in mind what I just mentioned the way the minority interest works here, you would adjust for that -- our return on equity for the quarter would be in the low 17%.

Operator

And our next question comes from [Phillip Travis]. Go right ahead.

Phillip Travis - *Analyst*

Hey. Good afternoon. First of all, thank for the presentation. My question is can you give us, please, an estimate price of the ordinary stuff that you're planning to issue and an estimate date of this process, please? Thank you.

Diego Solano - *Grupo Aval - CFO*

I can't give you a price because the price hasn't been decided yet. And that needs to be decided by a higher authority. What I can tell you is that we are bearing in mind as the elements (inaudible) is how has the price evolved in the past six months. We are bearing in mind that's not what the prices have previously issued have been. Those elements are being taken into consideration in addition to what the projections have (inaudible) looked like.

But at this time I can't really give you anything more specific than that because I don't really know it. Regarding timing, we should be close to finding the Superintendency we think the next few days. After finding the Superintendency there is at least a couple of weeks if not a few weeks in which we have to iterate with the Superintendency and then we will be opening to a process that will be taking around a calendar month to be completed.

So we don't know the time of completion given that we don't have the authorization of the Superintendency given that we haven't filed yet in the Superintendency. But once we get the approval to take another month.



Operator

And our next question comes from [Andres] (inaudible). Go right ahead.

Unidentified Participant

Good afternoon. My first question is related with Daniel Goriella's question regarding (inaudible) Columbiana. And the second one has to do with the investment portfolio. So you're mentioning a higher net income from (inaudible) Columbiana. And I remember that back in May you were expecting (inaudible) Columbiana's results to rely heavily on the infrastructure business. So I was wondering if you could elaborate on that result and it's evolution.

And the other question regarding the investment portfolio, if you're having an increase of 24% on a yearly basis on Aval's investment securities and they are around 16% on a yearly basis, on (inaudible), what's the strategy that you guys are considering in terms of classification and duration of this portfolio taking into account the mid-term expectations that we have on interest rate. Thank you.

Diego Solano - Grupo Aval - CFO

Okay. I'm going to answer the first one. And in the second one if I'm -- I'm not sure I understood your question. If I don't answer it please go ahead and (inaudible) question. Regarding the infrastructure, rather than dependency and infrastructure, (inaudible) upsetting the [past] that one of the core areas of investment this interest is infrastructure. And we are as of the rest of Colombian investors, waiting for the subsidiary substantial [coal road] and general infrastructure plan from the government to be deployed.

We are positive on the calendar starting to move at a faster pace given that the profits have already been kicked off. Our results through this quarter were not affecting in any special manner by the infrastructure business. (Inaudible) is more of our energy side of our portfolio. And it was the investment that contributed the most during this period. We are still looking forward for the positive affect that we should be having on infrastructure.

It's early to tell the size of that impact given that the business will be competitive processes. We are strong participants in that arena, but we haven't yet been awarded the contract, so I can't release the (inaudible) impact there.

And your second question, you started out with equities and then you moved to -- I understand that your fourth question is around debt, what to expect about the portfolio. I'm going to answer that. And if that's not enough please go ahead and re-ask.

Regarding investment [efficiency] is our fixed income portfolio has been performing at historically low rates for the past two quarters. The kind of rates that we have seen in investments were net interest margin of 1% for this period. And if you take into consideration our cost of funds, just (inaudible) and the (inaudible) will be around 4% as a result. The kind of numbers that you can see when you take up the prices of government debt, nowadays are at much higher levels.

So we should expect the levels to go up. They have already gone up in the treasuries market, the Colombian treasuries market. So the kind of rates we should be getting from our investment (inaudible) portfolios should trend up compared to the kind of figures that we have seen. Regarding exposure to changes in market rates, given that rates could go up the way that our fixed income portfolios have been positioned have taken into account those kind of (inaudible).

We have been shorting our maturities. And we have been growing our (inaudible) [for sale] portfolio we (inaudible) in our credit portfolio. This is a better positioning for this kind of other environment where you can profit from the higher rate at the time of purchase of the securities and mitigate the affect from volatility and prices [when you're creating portfolio].



Unidentified Participant

Thank you.

Operator

And we have no further questions at this time.

Diego Solano - Grupo Aval - CFO

If there are no further questions, thank you very much for your attendance and look forward to talk to you again.

Luis Carlos Sarmiento Gutierrez - Grupo Aval - CEO

Bye.

Operator

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

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