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GRUPOAVAL.BG - Corficolombiana's Unconsolidation at Banco de Bogota level Corporate Call

EVENT DATE/TIME: JUNE 24, 2016 / 4:30PM GMT



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PRESENTATION

Operator

Welcome to the call regarding Corficolombiana's Deconsolidation at Banco de Bogota level. My name is Hilda and I will be your operator for today. (Operator Instructions).

Today, the call will be conducted by Mr. Luis Carlos Sarmiento, CEO and President of Grupo Aval; Mr. Diego Solano, Chief Financial Officer of Grupo Aval, and Ms. Tatiana Uribe, Investor Relations Officer of Grupo Aval.

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

Luis Carlos Sarmiento - *Grupo Aval Acciones y Valores S.A. - CEO, President*

Thank you, Hilda. Good morning to everybody.

Over the past few weeks, after Aval and then Banco de Bogota announced its intentions to deconsolidate Corficolombiana, we've had several questions of people wanting to know in more detail what that deconsolidation entails. To that effect, we've put together a very short presentation that we can go over very quickly. And the way that I think we ought to do this is, first, I'll tell you what's in the presentation and then when we go into the strict detail, Diego Solano, who is here with me, can go through it column by column and line by line, if necessary.

The presentation is divided in three slides, and the first slide, it's the way that we have our holdings in Corficolombiana currently, and I want to emphasize that before and after that deconsolidation, those stakes that we hold in Corficolombiana directly in Aval and through three of our banks will remain identical. This is a strategic decision more than a decision that has to do with buying or selling stakes in Corficolombiana.

The second and third slides, what they're trying to do is show the effect of this deconsolidation in the calculation of regulatory capital here in Colombia, on the one hand, and also it tries to show the effect that this will have in the tangible common equity ratio that the regulator -- sorry, that the rating agencies do to determine the ratings that Banco de Bogota and Aval now will get.

So with that bit of introduction, let me jump into it and, first, well, as you know, Grupo and its banks, the three banks that own Corficolombiana, Banco de Occidente and Banco Popular, made the decision to deconsolidate Corficolombiana, which we did effective a few days ago. As a result, Banco de Bogota has ceded control and has ceased to consolidate Corficolombiana and will now only carry it as an equity investment in which it will reflect solely that 38.2% that it holds in that company.

For this data, as you know, by the Bank, Banco de Bogota controls and consolidated Corficolombiana as a result of a written agreement that had been executed between Grupo Aval and Banco de Occidente, Banco Popular, and Banco de Bogota, which, as you can see on slide number one, holds altogether cumulatively 58% of Corficolombiana.



The reason for this deconsolidation, most of you already know, but it primarily has to do with the Bank's decision to emphasize its financial operations and to deemphasize its non-financial holdings. This also serves, obviously, to ease the pressure on the capital of the Bank.

Grupo Aval will now exercise control of Corficolombiana and will continue, and I emphasize this, will continue to consolidate such investments because Aval already consolidated such investments and now we will do it directly. This control that it will now exercise over Corficolombiana, Aval will do it directly rather than through Banco de Bogota.

By not consolidating Corficolombiana in its financial statement, Banco de Bogota's figures and margins will reflect solely those of a banking operation. That will in turn make Banco de Bogota's consolidated balance sheet and income statement much more comparable with those of its peers.

Banco de Bogota will also, obviously, stop carrying the good wills and the intangibles that are on Corficolombiana's books and that by consolidating Corficolombiana with Banco de Bogota used to end up in Banco de Bogota's consolidated balance sheet. Therefore, the capital structure will be strengthened.

Additionally, the operation will only slightly affect the Colombian regulatory solvency ratios and will definitely increase the capital ratios as calculated by the rating agencies.

So those are the motivations behind this transaction that we just executed a few days ago.

So as I was saying in slide number one, what we wanted to show you there is how it is that the Group, and when I say the Group, I mean Grupo Aval directly with 9.4% and Banco de Bogota with 38.2%, Banco de Occidente with 4.6%, and Banco Popular with 5.8%, altogether control 58% of Corficolombiana. That, as I said, was in place before we made the decision and it's the same structure that we have today.

As I said, slides two and three, I will just briefly say what they contain and then Diego can dive into it, as I said, column by column or line by line. But what we're trying to show in slide number three where we show Moody's TCE calculation is basically what our rating was back in December 2014 when our TCE based on Moody's calculation was 6.33%. Back then, the Bank was investment graded in all of its different instruments, the Bank deposits, the [VCA], the base bank credit assessment, its senior unsecured debt, and its subordinated debt.

As of March of this year, not only was the Bank downgraded, but it was also put on what I would call a negative outlook that I understood Moody's calls it a bit different, something was put on review or something. But basically it means not only has it been downgraded, but we're considering downgrading you even more, and that was based on a new calculation being made of the TCE where they included 100% -- not only attributable, but 100% of the intangibles that were on Corficolombiana's books and that ended in the consolidated balance sheet of Banco de Bogota, as well as the attributable goodwill that ended up in Banco de Bogota's consolidated balance sheet.

With that and when they did their calculation, their TCE dropped to a low 3.75%, and as a result, they downgraded and put the bank under review.

With this first decision of deconsolidating Corficolombiana, what happens is that obviously the risk-weighted assets of the banks decrease and, on the other hand, obviously with it the intangibles that came from Corficolombiana will not be on the consolidated balance sheet of Banco de Bogota anymore.

On the other hand, when the Bank starts carrying Corficolombiana at fair value, now that it's not -- doesn't control it and under IFRS, then he has to book the difference between fair and book value of that investment, and that difference is about COP2.1 billion and that augments that -- it increases the capital base of the Bank.

Our calculation, this is our calculation and I've got to emphasize that. All that we are presenting to you are pro formas of calculations that we have done internally. This is after -- and I must say, this is after discussing what we are doing and what we have done with legal counsel, with regulators, and with the rating agencies based on -- and, obviously, with our accountants with KPMG. And based on that, we have put together these pro

forma calculations of what we envision might happen with both, on this page, the regulatory calculations and, on the following page, what we expect will happen with Colombian regulators.

So here what we see is that the 3.75% that Moody's calculated for Banco de Bogota as of March, after the separation, should end up in 8.25%, which, as you can see, is substantially higher than what it was in December 2014 when the Bank was investment grade. And then, as I said, Diego can go through this in more detail.

On the last page, what we're showing is what we expect will happen with the Colombian regulatory solvency ratio calculation. What it shows is that as of March what has been reported to the superintendents is a Tier 1 for Colombian regulators of 10% and a total solvency ratio of 13.7%. After March, we -- Banco de Bogota issued a new 10-year subordinated bond in the international markets for \$600 million and that increased the Tier 2 of the Bank.

In this upcoming shareholders meeting, the Bank will capitalize 50% of its income that it produced in the previous semester that will basically stop counting as Tier 2 and will start to count as Tier 1.

And then, you'll see the effect of deconsolidating Corficolombiana. On the one hand, you'll see the reduction of the risk-weighted assets, but on the other hand you'll see also that the minority -- the third-party minority interest that held Corficolombiana will stop counting towards the capital of the Bank. And Diego can explain exactly why, but that's the way that it worked because Banco de Bogota was consolidating Corficolombiana, it took advantage of the third-party minorities as part of its capital base and, obviously, it doesn't consolidate it anymore. It doesn't control it anymore, then it loses access to that minority interest capital held in Corficolombiana.

And then, the way that the regulations work here is when a Bank doesn't control a financial holding, it must deduct the debt holding from capital at its fair value. But on the other hand, it gains back in its capital ratio the difference between carrying the investment at book value and fair value.

As you know when you consolidate, you only carry the investment at its book value. Now that it doesn't, then it's just an investment, then it's got to add into the cost of the investment. It adds back the difference between fair value and book value, and that is an increase.

So it loses the -- when it calculates its regulatory capital, it deducts the total value of the way that it's now carrying Corficolombiana. So it deducts the whole \$3 billion at which it will carry or it's carrying now Corficolombiana, but then it gains back that difference between book value and fair value.

So in all, that is a net deduction of about -- an additional net deduction of \$1 billion. So once you put it all together with the new bond that it issued with the expected capitalization, with a reduction in risk-weighted assets, and the effect of having Corficolombiana now as a noncontrolled entity, all in all the Colombian regulatory capital stays -- the total stays at the same level and the Tier 1 is reduced slightly.

We think, then, that at the end the net effect of doing this and in conclusion is, one, the Bank gets to concentrate more on its financial holdings. Its balance sheet is now, I would say, 100% comparable with that of its peers. Aval assumes the control and exercises the control over Corficolombiana. The rating agencies should be happy because this has a profound impact on the estimation of the TCE.

And finally, the Colombian regulators should be content because the total solvency ratio is really not affected with the actions that we have taken, and the Tier 1 is only slightly affected, but it still will continue to be one of the highest, if not the highest, in the Colombian financial system.

And with this, and I hope not to have confused you too much, with this I'll pass it on to Diego and see how he wants to speak in more detail of what we are doing here.

Diego Solano - Grupo Aval Acciones y Valores S.A. - CFO

Given that Luis Carlos has gone through the fundamentals of how the calculations are done, I will only fill you in on some of the details of the calculation.



Going back to page 3, the numbers we have -- we present here for March are numbers based on the calculation that we understand and Luis has done. The actual numbers that were presented in the Moody's report were from December, but there's no material difference with what comes out as of March when you recalculate that.

As Luis Carlos mentioned, when we analyzed what was going on with our solvency, we realized that one of the main places where the numbers were being affected by the calculations of the rating agencies was consolidating Corficolombiana. So going back to page 3 under column B, the numbers that you will find here are when you look at goodwill, the goodwill that will remain after deducting Corficolombiana is the goodwill coming from our banking acquisitions, mainly the Central American acquisitions or almost only the Central American acquisitions.

And the other intangible [filings], what you'll find is intangibles coming from software mainly. If there are some pieces remaining from an acquisition that haven't been amortized as of these cuts, then intangibles from concession that are the main driver of deductions that we have under this previous calculation are stripped away. Therefore, we are able to reduce deductions that were bringing our attributable equity down from COP13 trillion down to COP4.7 trillion. We reduced these deductions to COP5.7 trillion. Therefore, the number for tangible equity is COP7.4 trillion.

And in column B, we have really a measurement of our investment in Corficolombiana full in IFRS 10, Paragraph 25, and particularly following interpretations under B98, which order us to remeasure to fair value our investments, and actually part of the things that we are revising is -- or reviewing indicates that we should take this difference to net income, either net income or income from previous periods. At this point, our understanding is, subject to review by KPMG, this might come through net income from the period.

Therefore, under full IFRS, our assets will grow; therefore, our attributable equity will grow by close to COP2 billion. The numbers that we present here are the numbers that we currently have. These might have some changes because this needs to be revised as of the date at which control is lost.

With this, we come to the numbers that Luis Carlos mentioned in our calculation of how the numbers might come up under the Moody's TCE calculation. And we turn to Moody's only, though a similar discussion is going on with Fitch. Fitch has also placed us under review and these numbers should also be positive for their calculations.

Now moving to page 4. On page 4, column A, the calculation that you see here is a calculation under Decree 2555 from 2012. This is the current regulation applicable to Colombia, which we come up with a core Tier 1 of 10% and solvency ratio -- a total solvency ratio of 13.7%.

In addition to deconsolidating Corficolombiana, we have also done a number of additional things, as you might see here. If we had only done the deconsolidation of Corficolombiana, our numbers would have fallen slightly under regulatory solvency, but we are doing a number of things in addition to deconsolidating Corficolombiana. It should take us to a similar level under total solvency ratios that we had in March.

These are the bonds that you're aware we issued recently, the \$600 million bond that adds COP1.75 trillion in Tier 2 capitalization. Then on column C, you'll see a negative in the Tier 2 line and a positive on Tier 1. This will happen when we have our shareholders' meeting and those earnings that we have earned already that we have committed to capitalize are actually capitalized.

Under Colombian regulation, when you commit income to be capitalized in the next shareholders' meeting, you get Tier 2 credit until the time when you move it to Tier -- or you truly capitalize that. So what we're seeing here is no movement in total solvency, but a movement from Tier 2 to Tier 1.

On column D, you'll see the same number that you saw in the previous page for consolidated risk-weighted assets. The only difference with the previous page is in addition to what happens under Colombian solvency, Moody's recalculates the weight of government securities and therefore risk-weighted assets on the previous page are slightly higher than what you see here.

Moving to columns E and F, under column E what you will see is what Luis Carlos mentioned, that there is -- Colombian solvency gives us credit for the equity contributed by nonrelated parties. This contribution is broken down into how the equity of Corficolombiana is built. The fourth part



goes to Tier 1 and part goes to Tier 2. We lose this benefit when we deconsolidate and this is one of the key drivers of why the numbers would have fallen in absence of the other things that we have done.

And finally, under column F, what you'll see is that our share of the book value of Corficolombiana that gets deducted in these calculations. So this is just additional detail on how the numbers are built. We now open it to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Anibal Valdes, Barclays.

Anibal Valdes - Barclays Capital - Analyst

Thank you for the call. Sorry if I missed something. I just wanted to make sure that I understand what Banco Aval is gaining in back of ceding the control of Corficolombiana to who is sitting at the control. And if there is a transaction, shouldn't Banco de Bogota be rewarded for selling the control of Corficolombiana? Thank you.

Luis Carlos Sarmiento - Grupo Aval Acciones y Valores S.A. - CEO, President

Something that perhaps we didn't emphasize at the beginning of the presentation is Grupo Aval already consolidates indirectly Corficolombiana. The reason why Banco de Bogota has been controlling Corficolombiana was not its right on its own due to its share of the company because it owns 38% of the stock, but because as a group we had agreed that it would be Banco de Bogota who would be controlling.

This control had some positives, but had substantial negatives that we are removing in this process, substantial negatives. Some are quantitative and pretty evident and they were let going around COP2 billion in equity that they are recovering in this process. And in addition, they were taking the burden of overseeing Corficolombiana from the risk management perspective and other perspectives.

Therefore, when the agreement that we have that was giving control to Banco de Bogota is removed, you end up basically with what we already had in substance. And it is that Aval had the overall control of Bogota. We are changing it; it is moving from indirect to direct.

And additionally, just to your question on the consolidated balance sheet and the consolidated P&L of Banco de Bogota, Banco de Bogota will generate COP2 billion in profits. So it's not exactly like their little shareholders are not being compensated. There will be a substantial profit booked by Banco de Bogota of COP2 billion, which is the difference between the book value at which it was carrying Corficolombiana and the fair value at which it will now carry it. So the consolidated equity of the bank will be boosted and benefited from the operation.

Operator

Nicolas Riva, Citi.

Nicolas Riva - Citigroup - Analyst

Thanks for taking my question. The first one is on slide three. If I look at your capital ratios according to Moody's, the pro forma capital ratio, 8.25%, is higher than it was, much higher than it was in March 2016 prior to the downgrade. Is it fair to assume, then, there is a good chance that Moody's will upgrade you back to investment grade equally in the case of Banco de Bogota and also Aval following this measure?



And then my second question, on slide four, so you are taking out the risk-weighted assets of Corficolombiana, the COP9.9 trillion. The only thing is before you were (technical difficulty) accounting for Corficolombiana at market value. Now you're accounting for Corficolombiana at book value and that's why you're putting the Tier 1, so your stake in Corficolombiana at book value. And this applies to Banco de Bogota.

And actually, just maybe a third one. There was another merger that also Banco de Bogota announced last week in their conference call, the absorption of leasing Bogota Panama. Do you also have numbers just like this of what could be the impact on the Tier 1 capital ratio of Banco de Bogota from that? Thank you.

Luis Carlos Sarmiento - *Grupo Aval Acciones y Valores S.A. - CEO, President*

Let's start from your -- from the third to the first one. On the third question, we are not as advanced on the merger of Banco de Bogota leasing Bogota Panama. We are getting the regulatory approvals, and as we get them, we'll be more certain of that operation and we will do a similar call to this one in which you'll see the benefits of that, and there will be benefits from that merger between Banco de Bogota leasing Bogota Panama.

Your second question, no, unfortunately, you've got it exactly the opposite. We were carrying Corficolombiana and Banco de Bogota consolidated balance sheet at book value. In fact, because we were consolidating it on the consolidated balance sheet of Banco de Bogota, we were carrying all the assets of Corficolombiana, all its liabilities. And the share of Banco de Bogota's equity at book value, the difference between -- that you create when you only carry your stake in Corficolombiana book value and you add the liabilities, there will be a difference between that and the total assets that you were carrying and that is basically minority interest.

What you're doing now is just the opposite that what you mentioned. Now you will carry that fair value so you get that boost in income and that boost in equity of about COP2 billion.

And on your first question, you know as well as I do we can't really talk about Moody's and what Moody's will or will not do. We are terribly hopeful, but you know that's all that we can be, and hopefully our hope will become a reality, but all that we can do is wait. Moody's will meet, I understand that maybe even today, I'm not totally certain. But they will meet in the following days to consider everything that we are talking to you and that we've announced to the market.

Operator

[Daniel Espinosa], [Sota].

Daniel Espinosa - *SOTA - Analyst*

I want to confirm if there will be any change in the Tier 1 of Grupo Aval on the consolidated balance sheet, and if you feel comfortable with these Tier 1 or you will take actions to increase this ratio. Thank you.

Luis Carlos Sarmiento - *Grupo Aval Acciones y Valores S.A. - CEO, President*

I'm getting a message here, I don't know if I'm online. I'm getting a message on my phone that you are no longer muted, which I hope I wouldn't be, but let me just start again.

As you know, Daniel, because you work in our markets, Grupo Aval does not report Tier 1. We are not mandated to do so. And just to add to that response, as we mentioned Grupo Aval will not change at all. The consolidated or the separate balance sheets of Grupo Aval will not change at all in this transaction. So whatever we had before, we will have after the separation is done.



In terms of -- now if your question was and maybe you misphrased it, but if you were not talking about Grupo Aval balance sheet, but you were talking about Banco de Bogota's, my answer would be certainly we are perfectly okay with those new ratios in Banco de Bogota.

Operator

And at this moment, we show no further questions. I would like to turn the call back over to Mr. Sarmiento for any final remarks.

Luis Carlos Sarmiento - *Grupo Aval Acciones y Valores S.A. - CEO, President*

No, I won't take any much more of your time. I think everybody is busy trying to analyze what Brexit means for all of us.

So I thank you all for being on the call and on this particular day, which I know was tough, but we hope to reconvene on our next call when we talk about the merger of leasing Bogota Panama with Banco de Bogota. With that, I leave you and I thank you all and have a great day.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference. We thank you for participating. You may now disconnect.

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