4Q - 2018 Results Presentation Transcription

BBVA Colombia

BBVA Creating Opportunities

Audio-Conference 4Q18

[Natalia Neira] Good morning, good afternoon and good evening to our investors connected around the world, you're welcome to our fourth quarter 2018 Results event. My name is Natalia Neira and I'm part of the legal department of BBVA Colombia. In this event is also connected Alejandro Reyes, Principal Economist and Carolina Ramirez, Director of the Financial Management Department, who will give the presentation.

The corresponding documents were sent to you through email, both in English and Spanish, and will be available in our website in the section "Investor Relations" on the link "Agenda". We ask you to please mute the microphone of your phones to have a better communication. Without further ado, I give the turn to Carolina.

[Carolina Ramirez] Thank you very much Natalia, Good Morning and welcome to all of our investors and shareholders connected to this call, in which I will present the results for the fourth quarter of last year for BBVA Colombia. As Natalia mention, we already send you all the material via email both in English and in Spanish through your email.

I will start with a brief overview of the macroeconomic scenario and later I will explain the highlights of our results for the quarter. First of all, I will start with our macroeconomic outlook on slide number 3.

According to BBVA Research, global economy will slow down in 2019 and 2020. This deceleration will be driven by the less than expected expansion in the US due to a deterioration of trade and a fading fiscal impulse. Indeed, BBVA Research estimates GDP growth in the US to drop from 2.9% in 2018 to 2.5% in 2019 and then to 2.0% next year. With this, the oil price, which stood at USD 72 per barrel on average in 2018, is expected to average USD 63 in 2019 and fall to USD 56 in 2020.

In this sense, the global context for coming years is likely to be more challenging for the Colombian economy with a deceleration in the US growth and a drop in oil prices.

BBVA research expects the Colombian economy to slowly recover in 2019 as local factors also pose some challenges. First, the current account deficit increased in 2018 to an estimated 3.5% of GDP, even though the average price of oil over the year was 32% higher than in 2017. Second, the tax reform approved by the end of last year, while not affecting to a large degree Colombian households capacity to pay, did push confidence down, as situation that has extended in the first months of the year. Additionally, the tax reform has been questioned in terms of its sufficiency to cover fiscal needs for this and next year, reducing the room for large public expenditure.

All in all, the external and domestic outlook looks challenging for the Colombian economy and will mean that the recovery of GDP, while steady, will be slow and gradual, with less support from external trade and public sector spending. Indeed, the main sources of recovery in 2019 and 2020 will be private consumption and investment. Private consumption will continue to be driven by the purchase of durable goods and, later, by spending on services, and will return to growing slightly above GDP in 2019 and 2020. Meanwhile, residential construction is expected to recover this year, boosting investment growth to 3.9% this year and 4.8% next year.

With this, the Colombian economy is expected to consolidate its growth during 2019. BBVA Research expects the economy to grow 3.0% in 2019 and 3.3% in 2020, recovering from the 2.7% growth rate saw in 2018 and the 1.4% saw in 2017.

Continuing on slide number 4, with the expected growth rates, not being very high, economic activity will not represent a significant pressure on prices. BBVA Research expects inflation to remain very close to the central target of the Central Bank at 3.0%, ending 2019 at 2.95% and 2020 at 3.22%. As inflation will be under control, the role of the Central Bank should be cautious. Based on this, BBVA research expects the Central Bank to increase its interest rate just once in 2019 by 25 bps, in the last quarter of the year. In 2020, they expect one more hike, taking rates to 4.75%.

Under this macroeconomic environment, I would now like to point out the main highlights of our results in the fourth quarter of 2018, moving to slide number 5.

BBVA Colombia showed positive results in the fourth quarter of the year. Our net interest income increased 10.8% yoy, our gross margin grew 5.1% yoy and our net income increased 14.8% yoy. These results are mostly explained by lower funding costs and high commercial spreads that helped our Net Interest Income to continue outperforming.

In terms of our balance sheet, total assets closed at 63 trillion pesos, with a growth of 8.3% compared to the last year; the gross loan portfolio registered a yoy growth of 4.4%, ending the period at 45.5 trillion pesos, while customer deposits grew 3.7% yoy, closing with a balance of 45.6 trillion pesos. As for risk indicators, we saw an increase of 50 bps in our NPL ratio compared to December of 2017. The portfolio that contributed the most was consumer loans, which deterioration continues to respond to the slow recovery of employment. However, our cost of risk declined 40 bps by the end of the year, compared to the end of 2017.

We have also maintained very good solvency levels well above the minimum required by regulation, ending the year at 12.35%, increasing 9 bps compared to the end of 2017. Finally, our efficiency ratio continues to improve, decreasing 225 bps compared to the previous year.

On slide number 6, I would like to share our results in terms of digital trends. BBVA Colombia managed to close the year with a very positive balance as a result of the consolidation of our digital strategy and by the end of last year, we exceeded one million digital customers. Indeed, we closed the year with 1.2 million digital customers, 29% more than in December of 2017 and 1.1 million mobile customers, 40% more than in December 2017. This was possible thanks to the development of a wide digital offering, led by self-management products that has motivated a transformation of the transactional preferences of our customers. The products incorporated into our digital portfolio throughout last year, were consumption loans, payroll loans, online accounts, investment funds, mandatory vehicle insurance, among others. This has boosted the participation of digital sales to 15% of total sales. All this reaffirms the positioning we want to have in the Colombian financial sector and the success of our digital strategy that we will continue to execute this year.

I will now present the main figures for the fourth quarter, showing first the results of the period, then the highlights of our balance sheet and commercial activity and finally our solvency ratio.

We now move into the results of the fourth quarter of 2018, starting in slide number 9.

We continue to show positive results in our interest margin, increasing 10.8% for all 2018. Our interest margin benefited from the interest rates cuts implemented by the Central Bank in 2017 and 2018 that has reduced our cost of funds, given that our funding structure is balanced towards more variable rates and inflation-linked instruments. At the same time, we have managed to keep high commercial spreads, taking our net interest income to outperform all throughout the year. In the last quarter of the 2018, our interest margin continued to grow by 2.1%, compared to the same quarter of 2017, despite monetary policy rate cuts were executed in the first half of the year. Looking forward, we continue to execute our strategy to optimize our funding sources composition and seek to take advantage of lower inflation this year and a more neutral impact from potential interest rate increases in the coming years.

On slide number 10, we see that fee income increased 11.4% yoy in all 2018. This is mainly explained by lower fees paid to our external sales force, less fees paid due to lower cash purchases and higher investment banking fees that more than offset the reduction in fees of interbank transfers, implemented to a large base of our retail clients.

Moving on to slide 11, we see a significant improvement in our efficiency ratio, with a decrease of 225 bps yoy. This is explained by a reduction in expenses during the year, with a reduction of 0.02% yoy. Compared to the previous quarter, operational costs saw also a decrease of 2.8%, especially driven by lower cash purchases to the Central Bank that have been allowed by our strategy of cash collection agreements with big corporate clients that manage large amount of cash. Additionally, our digital strategy has enabled us to reduce costly operational activities.

Finally, BBVA Colombia recorded a net profit of 564 billion pesos in 2018; an increase of 14.8% compared to the last year of 2017, mainly as a result of higher interest margins, a decrease in expenditure and from a reduction in the provision expense as a result of portfolio recovery efforts.

It is worth mentioning that there was a decrease of 80% in the last quarter of the year in our net income, given two extraordinary effects: First, the income generated in the fourth quarter of 2017 by the Deceval sale and second, the expense for the 20% provision left to complete the full provision of the Electricaribe loan.

As for return on equity, BBVA Colombia saw an increase from 11.46% in December 2017 to 13.39% in December 2018, well above the industry's average. The positive trend for the return on assets maintains, going from 0.85% in December 2017 to 0.94% in the same period of 2018.

On the slide 13, you can find the main figures of our consolidated income statement.

Now, I would like to present our highlights in terms of our Balance Sheet and Business Activity.

On slide 15, you can see that our loan portfolio increased 4.4% yoy to 45 trillion pesos. BBVA Colombia maintains its focus on the retail segment, which represented close to 60% of the total gross portfolio in the last quarter of the year.

Additionally, the portfolio growth was driven mainly by our good performance in consumer loans and mortgages with a yoy growth of 8.7% and 8.5% respectively. Meanwhile, the commercial portfolio showed a decrease of 1.5% yoy.

On slide 16, we show our funding sources composition.

During 2018, BBVA Colombia maintained a solid liquidity position, increasing stable resources through savings from the retail segment.

In this way, customer deposits grew at an annual rate of 3.7%, closing the quarter at 45.6 trillion pesos. Given the high levels of liquidity in the economy during 2018, the participation of savings and checking accounts grew, with a yoy growth of 8.8% and 12.8% respectively. This allowed us to reduce our funding through time deposits, and ultimately a reduction in our financing costs. In this way, term deposits showed a decrease of 3.5% yoy.

On slide 17, we show the main highlights of our business activity.

We decreased our market share by 16 bps last year. This is a result of our strong focus on optimizing returns on capital that lead us to create value mostly through high commercial spreads and less via volumes. In addition, the fact that BBVA has to comply with international regulation in terms of liquidity and capital requirements, poses a competitive disadvantage especially when pricing commercial loans. This situation exacerbates when interest rates reach minimum levels and the industry enters into fiercer competition. As a result, our market shares in commercial loans decreased by 34 bps in the fourth quarter of the year. However, we managed to increase our market share in the SMEs segment, one of our strategic pillars.

On the retail side, we saw a slower dynamic due to the macroeconomic slowdown, so consumer loans showed a decrease in market share of 3 bps. However, credit cards showed better growth, resulting in market share gains of 4 bps.

Regarding to deposits, we saw market share increase of 0.15 bps, driven mainly by saving accounts, with a market share growth of 25 bps, followed by checking accounts with a market share gains of 78 bps. While term deposits showed a reduction in the market share of 95 bps, given our strategy to reduce our funding costs.

Now, on slide 18, you can see that the NPL ratio closed at 3.96% in December 2018, showing a deterioration of 50 bps compared to the ratio reported in the previous year. The portfolio that contributed the most for this result was consumer loans, which deterioration is mainly explained by the slow recovery of employment.

However, there is an additional aspect to this. BBVA did not carry out any write-offs in the fourth quarter of last year in our consumer portfolio. It is important to indicate that BBVA's write-offs are aligned to Basel III policies that allow the cancellation of assets only when there is no recovery viability. As shown in the chart, BBVA's NPLs plus write-offs compare very positively vs the sector, showing the higher quality of our portfolio. In addition, during the year, initiatives to implement recovery strategies materialized, ending in lower provisions expenditures. This is reflected in the lower Cost of Risk, already mentioned before.

Furthermore, NPL ratios of the commercial portfolio remain at lower levels than the sector's average given our low participation in distressed transactions. In fact, the Electricaribe's loan was 100% provisioned in October. Meanwhile, mortgages' quality continues to perform much better than the sector.

On slide 19, you can find our detailed balance sheet, of which I already mentioned in the main highlights.

Finally, in terms of our capital adequacy on slide 21, BBVA Colombia closed 2018 with very good solvency ratios, well above regulatory requirements. We saw a 12 bps increase in the solvency ratio in the fourth quarter compared to the third quarter of the year due to lower RWAs given the moderation in our commercial loan portfolio.

In order to bring the regulation of the Colombian financial system closer to international capital standards, regulators have published new legislation that includes two main points. The first is the configuration of financial conglomerates in Colombia and the second refers to the convergence to Basel III in terms of adequate capital requirements.

Since 2017, progress has been made in the regulation of the Conglomerates Law in Colombia and this year 13 financial conglomerates were determined, of which five are local and eight are foreign, as is the case of BBVA Colombia.

The regulation also establishes the adequate capital levels of the conglomerates, the criteria of entity linkage to the conglomerate was established, as well as the guidelines for managing conflicts of interest between conglomerate's entities and their affiliates. Regarding of convergence towards Basel III, new guidelines for TIER 1 were released, as well as the definition of the additional basic solvency limits and advantage, also conservation and systemic buffers were established.
Likewise, the standard method of calculating RWAs levels will be implemented, taking asset weighs down significantly, which will imply a significant decrease in equity consumption. Under this new regulation, we

do not expect unfavorable impacts on the solvency level of BBVA Colombia.

With this, I end my presentation and open the line for any questions you may want to ask.

[Natalia Neira] Since there are no questions, then we conclude our event. We appreciate your participation and we hope you have an excellent day.

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