CONFERENCE CALL SCRIPT
BANCOLOMBIA’s 2Q18 RESULTS

FORWARD LOOKING STATEMENT DISCLOSURE; NON-GAAP MEASURES DISCLOSURE
OPENING REMARKS
RESULTS SUMMARY
(Slide 2)

JUAN CARLOS MORA:

Good morning and welcome to the conference call for the second quarter.

I want to start this call, making a reference to the most important fact of the current situation of our business.

- We are going through a challenging credit cycle and we have experienced significant deterioration in the loan portfolio.
- The level of new past due loans is mainly explained by corporate loans, including troubled clients that we have shared with you in previous calls.
- In the SME front, we perceive an improvement of the situation, even though we still have some way to go, which is in line with the economic recovery that Colombia is going through.

These trends, though, confirm our assessment regarding where we are in the cycle. We have elements to believe that we are reaching a turning point and we expect a normalization in the coming quarters.

Over that last year, we have accelerated the pace of provisioning, acting early to reach coverage ratios that permit to protect the book. As a matter of fact, some of the loans that are becoming delinquent today, have been provisioned already and that means that we do not expect a significant increase in the cost of risk, despite potential new Past Due Loans.

This situation with the credit portfolio contrast with the very positive trends:

- A good performance of margins, thanks to the management of the funding costs
- A solid and improving capital position.
- And finally, a very good performance of costs, thanks to the efforts made to lean the bank in several aspects.

Having said this, let me elaborate more on the macro and four relevant aspects that are driving our business:

**Macro environment and Politics:**

- After the elections for congress and president held in the first half of the year, the political landscape seems to be more constructive.
- The macro conditions in Colombia are stable and favorable for growth over the next 24 months.
- In particular, we must highlight the following facts:
  - Inflation has been within the range set by the Central Bank during several months in a row.
  - The outlook for GDP growth has been positive and this second half of the year the pace of economic activity should accelerate as both the public and private sectors resume investments programs.
  - And finally, the external front and the trade balance seem to be quite benign for the FX and the current account deficits.

As a consequence of favorable macro forecast, we could see two effects:
1) More activity across the segments that the bank targets.
2) Improvement in the credit quality, especially in the corporate and SME segments.

**Loan Volumes and Credit Demand:** The pace of growth has been slower than our expectations. This is partially explained by the slow first half of the year, when corporates behaved in a cautious way while they had more certainty in the political front.

As of June, the loan portfolio grew 3.2% year-on-year and most of this growth is explained by the consumer book.

As you know, we intend to grow the consumer segment faster, in order to balance the composition of the book. Analytics and the improvement of client understanding processes have permitted to achieve the goals while keeping the risk within our risk appetite.

At the same time, we have become the first player in retail banking in Colombia, as we went from 13% to 17% market share. Let’s remember that consumer loan growth in 2017 was 15% and the year on year growth as of June was 10%.

In the commercial front, our main efforts have been concentrated in the management of large corporate issues and the normalization of troubled clients, specially SMEs. This is the segment where demand has been weaker and where the collection efforts are focused.

**Margins and cost of funding:** Given the slow growth of the portfolio, we have concentrated our efforts in the defense of the NIM. Our strategy here has been to reduce the cost of funding as fast as possible, especially in Time Deposits. The level of liquidity in the economy permits us to avoid significant pressure on the funding side.

In this sense, margins have evolved better than we had forecasted at the beginning of the year. The 5.9% posted in this quarter reflects better margins in the dollar denominated portfolio, and the reduction of funding costs in Colombia.

We forecast stability in the interest rates in Colombia for the rest of the year, and therefore, net interest income will grow in line with the loan portfolio expansion.

**Credit Cycle and asset quality:** In line with the economic cycle and the situation with certain corporate clients, we continue having a high pace of provision charges.

Regarding the quality of the portfolio, we must highlight the following:

- In the origination process, new vintages in both commercial and consumer loans are behaving in line with our forecast.
- The growth in provision charges has been driven by the deterioration of some corporate clients, not necessarily past due, and the run-off of SME clients.
- We could say that the loan portfolio starts a new cycle with better levels. Nonetheless, there are some corporate cases that will become past due but will not require additional provisions because we have made some in advance.

An action that we have taken to control the deterioration is to re-enforce the collection process and monitor very closely clients with potential problems. The goal is to prevent the formation of Past Due Loans and the run-off of vintages that are in early stages of trouble.
The cost of credit for 2018 will be above our initial forecast, and we will be reaching around 2.2%, which is higher than the 2% forecasted at the beginning of the year.

It is important to note here that some of the loans that became past due in the quarter had been partially provisioned with charges in previous periods. That means that we have moved in advance to protect the balance sheet and to some extent, we have already covered a significant portion of loans that are just appearing as trouble.

**Efficiency and Cost control:** This remains a key topic for 2018. We are keeping our goal of growing expenses below 5% this year and so far, the results have been quite positive. Operating expenses for the first six months of the year have declined 1.4%. This negative growth if the result of the accelerated expenses in the first half of 2017, mainly related to bonus plan payments, higher VAT expenses, and the wealth tax.

Normalizing the comparison base, the cost growth would have been 4%, which put us on the way to our year-end target of growing expenses around 5%.

The structural gains in efficiency have been a combination of factors:

1) As we shared with you in previous calls, the headcount of the bank has been reduced
2) We have reduced the number of branches in Colombia and Guatemala in order to optimize costs.
3) We continue gaining efficiencies and involving technology and automation in several processes across the bank. Today we have more that 160 processes that involve robotics or artificial intelligence, and the productivity gains have been enormous. Collections is a good example: today: we conduct automatic debits of past due clients on a daily basis, 24 – 7, with no marginal cost whatsoever.

With these elements in mind, I want to ask Juan Pablo Espinosa, our chief economist to give you an overview of the main macroeconomic topics to consider, Juan Pablo.

**JUAN PABLO ESPINOSA:** Thank you Juan Carlos. Now, I will ask you to go to slide number three (3) in the presentation.

Slide 3

In first place, it is worth mentioning that during the past months global conditions have remained sanguine for the Colombian economy. The rise in the prices of oil and other commodities have led to a surge in the country’s terms of trade, which are now 63% above their lowest reading recorded at the start of 2016. Moreover, at the end of May the YoY growth of this index is 14%.

This performance of external prices, as well as the solid growth of Colombian main trading partners, has led to a two-digit increase of exports, which will lead to a further narrowing of the current account deficit.

Due to all these factors year-to-date the Colombian peso has been one best performing currencies of the region. Our baseline is that the performance of external variables will continue to be positive through the second half of the year.

With respect to economic activity, recent indicators have shown a widespread improvement. According to our estimates, during the second quarter GDP expanded 2.6% YoY, 0.4% higher than first quarter’s print. Meanwhile, job creation is accelerating, retail sales have recovered, and after a long period of weakness
manufacturing production is growing again. All this has been complemented by a steady increase of both consumer and business confidence.

Based on this evidence, we have revised upwards our FY 2018 growth forecast to 2.6%, slightly above market consensus. This implies that during the second half of the year the economy will expand close to 2.9%, thus confirming the pace of gradual pickup in activity that we have been anticipating since last year.

In terms of prices, after accelerating just 6 bps in the second quarter to 3.2%, we slightly adjusted our year-end inflation forecast from 3.3% up to 3.4%. This will mainly reflect an acceleration in food prices during the fourth quarter. There is also an increasing probability of a moderate El Niño phenomenon between the end of 2018 and the beginning of 2019.

Regarding monetary policy, we forecast that the Central Bank’s reference rate will remain at 4.25% for the rest of 2018. We believe that rate stability will be the most appropriate response for an economy that will still grow below potential but is exposed to higher interest rates in developed economies.

[Juan Pablo Espinosa: After this overview of the economic environment, let me turn the presentation to Jose Humberto Acosta, who will discuss the Bank’s results.]

Jose: Thank you, Juan Pablo.

Slide 4

Before starting with the discussion of the consolidated results, I would like to highlight the main aspects of each geography, please go to slide number 4:

- In Banco Agrícola in El Salvador:
  - This operation presents growth signals and improvement in yields. Growth has come from both commercial and consumer loans and that has permitted to expand NIMs from 5.9 to 6.9%.
  - In the fee front, the implementation of new products has permitted to grow these revenues 7.1%.
  - Cost control programs have permitted to improve efficiency levels from 56 to 51%.

- In Banistmo:
  - The growth of the loan portfolio has been slower than expected, impacted by the deceleration of the panamanian economy, which we believe will grow 4% this year.
  - The implementation of IFRS9 has permitted to increase the coverage ratio to 123%.

- Finally, In BAM:
  - The coverage ratio has increased to 160%.

In general terms, the main goals for Central América is to grow the loan portfolio and to continue gaining efficiencies.

Since Colombia is the main component of our consolidated operations, we want to zoom in that geography, please go to slide number 5:
Note that these metrics, are for our stand alone operation in Colombia.

We must highlight two facts that drove the business over the last year:

1) First, we maintain a very strong competitive position. In commercial, corporate and SME banking, more than a third of the total market re-affirms the capacity of Bancolombia to serve clients with comprehensive solution.
   I want to point your attention to the evolution of market share in consumer loans, which has gone from 13 to almost 17% in two years. Most of this growth has been within our own base of clients, which we know better since they typically have a relation with us in the deposit side.
   The use of predictive tools allows us to estimate the payment capacity with higher accuracy and therefore originate loans more efficiently.

2) The evolution of NIM has been quite positive thanks to our efforts to bring down the cost of funding. Please not that while the reference rate in Colombia came down 325 basis points over the last year, the NIM came down 120 basis points. Over the last six months, it seems to have stabilized around 6.3. This comparison is the outcome of the strong franchise in deposits that Bancolombia has, especially in retail funds which provide stability and competitive cost.

On slide 6, we see the evolution of the loan portfolio.

As we shared with you at the beginning, credit demand has been week during the first half of 2018.

The loan portfolio in pesos grew 8.7% year on year and the loans in dollars decreased 2.7% in dollar terms, for a combined effect of the 3% year on year growth.
The impact or appreciation of the peso versus the dollar during that period was about 1.2%.

The most important trend to highlight regarding growth is the relevance that consumer loans have gained in our portfolio. Today, that segment accounts for more than 17% and that strategy has contributed to improve margins and returns.

On the other hand, the share of mortgages has remained stable round 13% over the las two years and we intend to keep it around that.

As Juan Pablo mentioned at the beginning of the presentation. We expect a faster growth of the economic activity during the second half of the year, and this will help the credit demand.

Based on this, we have changed the estimated forecast for loan growth for the full year to 6 % to 8%.

Moving on to slide 7, we present the situation of the credit quality as of June.

We continue experiencing the effects of the credit cycle and NPL ratios for 30 and 90 days. This trend is exclusively explained by corporate loans, because SME, consumer and mortgages seem to be reaching a turning point in the quality metrics.

Regarding corporates, we need to mention that the increase in the NPL ratios is largely explained by the delinquency of clients that has been in the watch list but were not yet delinquent.
To some extent, these were expected cases that had not impacted the delinquency ratios in March. Nonetheless, we have done provisions for them in advance.
In consumer and mortgages, we perceive a change in trends in the 90 day NPL ratio, which suggest a change in the cycle, where as in corporates, we still see deterioration.

A similar effect occurred in the 90 day NPL ratio, which increased in the quarter because some of the loans are running-off and reaching that threshold. That’s why the 90-day NPL ratio goes up faster than the 30-day ratio: there is a lag effect.

We must highlight that we maintain coverage ratio levels enough to operate, due to:
- Higher provision levels related to corporate clients.
- Implementation of IFRS9, which increase the allowances by 600 billion pesos.

Slide 8

Slide number 8 helps to understand what’s happening with the credit cycle.

During the quarter, 1.15 trillion pesos became delinquent 30 or more days. Almost 160 billion of those, are corporate loans related to Electricaribe and the Mass transportation system that were not delinquent yet.

So, taking out these large issues, the new past due loans seem to be moderating, especially compared to the first quarter of the year.

We continue experiencing deterioration in mid-size corporations but on the other hand, the trend in Small Enterprises (SMEs) is reaching a turning point and after having significant defaults in 4Q17 and 1Q 17, we are back to the levels of the first half of 2017.

We do not associate any particular sector to these new delinquencies, but certainly the last twelve months of the economy have contributed to this trend.

Regarding consumer loans, we are focusing our originations in the best clients from a Risk perspective. This is the segment where we do not have any major concern because it has behaved in line with our expectations. We maintain a cautious approach to disbursements, but we are positive regarding the general condition of Colombian consumer debt and in particular, Bancolombia’s clients.

Right now, we continue the process of de-risking the loan portfolio replacing old vintages with new ones—under more stringent standards.
The environment is also in our favor: households are reducing the leverage (a trend that began about 18 months ago) and leading indicators like un-employment is moving downwards.

Now we can argue that we are back to the same levels of deterioration of mid 2017 and as the second half recovery occurs, we could continue seeing an improving trend. We perceive the current situation of the cycle as a transition period towards a better performance of the book.

Equally important, is to mention that we have accelerated the pace of charge offs. This has been only possible thank to the provisions made over the last year and this should continue for the next two quarters.

Finally, I would like to mention the actions that we continue taking to navigate the credit cycle:

1) Early delinquency and collection process: we have enhanced our collection teams in order to concentrate efforts that prevent clients to become delinquent and in case they are past due a few days, to avoid them reaching 30 days.
2) Working with troubled clients: since most of the clients are delinquent due to involuntary circumstances, we have been working with them to restructure some of the obligations, offering solutions that are more convenient.
For instance: a client that has an obligation in dollars is able to change it to pesos and therefore, the cash flow volatility improves.

Having said this, we estimate that the cost of risk will be around 2.2% for 2018.

Slide 9

Moving on to slide number 9, we see the evolution of Net Interest Income and the funding cost.

The most important fact to highlight regarding NII is the effort we have made to bring down the cost of funding.

In an environment where credit demand is not strong, defending the NIM takes more relevance.

Three actions taken to bring down the cost include:

- We took advantage of the ample global liquidity to take deposits in dollars through our off-shore subsidiary in Panamá, hedge and monetize them and then use the proceeds to originate loans in pesos. During the first half of the year, we monetized 1000 million dollars and the total cost paid for those resources was 165 basis points lower than the comparable CD cost.
- We issued 300 billion pesos in green bonds, which permitted to take mid-term funding at a very competitive cost.
- We reduced lines of credit from international banks by 400 million dollars.

All included, we could reduce the total funding cost of the bank by 48 basis points in the last year, but most importantly, the cost of deposits in pesos, came down 99 basis points in the same period.

To reach that reduction, we promoted savings and checking accounts over CDs taking advantage of the base of clients in Colombia.

It is also remarkably that despite the FED interest rate hikes, the cost of dollar denominated deposits has gone up marginally over the last year. In Banco Agricola and Banistmo we promoted savings and checking accounts as well.

As a result of this effort, the margins remained stable. In the following slide, number 10 we can appreciate the trend in Net Interest Income:

Slide 10

NIM of the loan portfolio was stable during the quarter as a result of the parity between reduction of the average yield on the loan portfolio and the funding cost.

Two actions helped the stability in the lending NIM:

1) We have grown in consumer loans at around 17% in Colombia, and these assets have a higher margin.
2) In the funding side, as we just mentioned, we have optimized the funding costs.

On the other hand, there was an improvement in the NIM of securities as volatility was reduced after the congress elections in March and government securities have appreciated.

The combined effect was a slight improvement in the overall NIM, which was in 5.9 during the quarter.

In line with our expectation we are getting closer to lending NIM of 6% and a total NIM around 5.8% by year end.
On slide 11, we can see the evolution of fees.

Fees presented a mixed trend in the second quarter: revenues evolved very well, mainly impacted by the promotional programs of credit cards related to the world cup, but at the same time we had higher expenses related to distribution channels, such as baking agents and call centers.

Asset management and bancassurances, behaved in line with the trend seen in the first months of the year.

In order to isolate seasonal effects, it is useful to see the cumulative performance of fees. They have grown 6.8% in 2018. This pace of growth is in line with slow economic activity observed in the first half of the year and we expect to accelerate in the third quarter as the economy get traction.

Our forecast for fee growth in 2018 is between 8% to 10%.

Now, moving to slide 12, we present the evolution of expenses,

The results in efficiency have two rationals:

From the revenue side, net interest income did not growing at the expected pace due to the low grown in volumes and the no-accrual of around 106 billion per quarter of interests attributable to bucket 3 classified clients.

In the Opex side, we have seen a decline of 1.4% due to the programs that we have put in place, in particular:

1) The headcount of the bank has been reduced at the same time that we are implementing Robot Process Automation initiatives in activities that used to have a significant labor cost.

2) We have shut down branches in Colombia and Guatemala in order to optimize costs and to continue with our migration to low cost channels, including Banking Agents, online and mobile banking.

3) We have tighten the control over projects undertaken by the bank, to concentrate the efforts only on those that are crucial for the implementation of the strategy.

In the tax front, the reduction on the effective tax rate is explained by two reasons. In the second quarter, we’ve re-calculate the deferred taxes using the forecast statutory rate of 33% for 2019 based on the last tax reform. In the second Quarter also the earnings of the subsidiaries in Central America are bigger, since the tax rate is lower this effect reduces the overall consolidated tax rate. Just to give you an idea, the statutory tax in our operations in El Salvador, Guatemala and Panama is 25% and the statutory tax for our offshore operation is zero percent. So if you combine that, the tax rate will be at around 30% to 32%.

Based on the evolution, we forecast an Opex growth of 4 to 5% in the year.

Now, let’s move to slide 13 where we present the evolution of the capital position of the bank and the Tier 1, which ended at 10%.

We have not seen a significant change in the capital ratios over the last year due to the stable size of the balance sheet and despite the adoption of IFRS 9, which reduced shareholder’s equity.

For the rest of the year, we should operate with total capital ratio of 13 to 14%.
Finally, on slide 14 we present the ROE for the period, which was 10.6%. For the last twelve months it was 11%.

In summary:
- The economic cycle indicates us that the level of provision charges is currently reaching the peak.
- For the second half of the year, we have:
  - Potential faster growth of the loan book.
  - Funding structure that could maintain the lending margin around 6%.
  - Growth in expenses under control and expecting around 4.5% for the full year.
  - The international operations will help to gain efficiencies.
- Finally, the capital structure is optimal to face the new economic cycle.

After presenting these slides and discussing our second quarter results, I would like to invite our audience to ask any questions you might have. Thank you.

Questions and answers

First question

Ernesto Gabilondo Analyst at Bank of America-Merrill Lynch

Hi. Good morning, Juan Carlos, Jose Humberto, and good morning, everyone. Three questions from my side. The first one, we saw modest economic recovery and that explains the limited loan growth. However, can you share with us which are the tangible programs or projects of the new administration that are making you to become more optimistic in terms of loan growth in the second half. We saw that almost all of the segments of the portfolio experienced a slower pace of world on a daily basis. So just want to know, again now, what is making you to be more comfortable, not only related to the economic activity, but projects or any other indicator that could help us to be expecting faster growth should be very helpful?

Then, my second question is in terms of asset quality. We continue to see that the large troubled corporates are the one affecting the provision charges and I think that's a reason why you increased the cost of risk guidance to 2.1%. But can you share with us how much provisions have you already created on these large corporate loans? Are they already provisioned at 100% or how much is still pending. And finally, can you repeat how do you see the ROE for the year? Thank you.

Juan Carlos Mora, Chief Executive Officer

Ernesto, thank you for your questions. Let me start with the recovery aspect. We have seen that the economy in Columbia is picking up already. You mentioned that the growth of our portfolio has been slow and that's true. But I would like to highlight that we have been gaining market share.

Looking forward, we see that the consumer confidence is increasing, economic activity is improving. So we will see more economic activity on that front. We will forecast a bigger demand. On the government side, the new government will be taking office next, but still the infrastructure program is in place and will demand additional finance. And also we see an increase activity from the enterprises evaluating new projects and we will see additional demand coming to finance these new projects that are going to create additional capacity for the economy.

Also, I would like to highlight that, we are -- we keep moving on the direction of pre-approving line of credits for our customer, for our retail business and this is a big improvement. So we are not reacting to the demand.
We are moving ahead and evaluating the customers, defining the line of credit, and that is create an additional demand for us with a very good credit quality. So we were optimistic that the recovery is coming and the demand will improve moving forward.

In terms of asset quality, we have mentioned that we have been moving on provisioning the big customers, the big clients, corporate clients. Already, we have provisioned the Electricaribe loans are around 65%, which is sufficient due to the current situation of that customer and on the SATP front, which is the mass transportation systems, we are around 46%, which we also consider a sufficient coverage. So we'll keep moving and analyzing the development of these customers. But as of today, we think that the level of provisions that we have with those customers is -- it's enough.

Regarding your third question about ROE forecast. We forecast that our ROE will be at around 12% for this year and we are confident that ROE will improve significantly for next year.

Second question

Jason Mollin, Analyst at Scotiabank

Hi. Thank you for the opportunity to ask questions. My first question is a follow-up on the outlook for profitability. I think with the higher provisions it seems like it -- it might be hard even to reach the 12%, which I believe is down from the 13 that you were talking about after the last quarter at the beginning of the year. What do you think the upside or downside risk is for 2018, for the second half, is it that -- is this 12 on the upside as this -- as the economy recovers as you expect? Is there no more, what kind of volatility you're expecting for the FX, et cetera. And the second question is more of a detailed question on the cost of funding, that's been really an impressive trend bringing that down. What are you seeing there in terms of competition and can that downward trend continue or do you think as the economy grows, there will be more competition for funding and low cost deposits and actually that trend could reverse? Thank you.

Juan Carlos Mora, Chief Executive Officer

Thank you, Jason. Let me elaborate a little bit on the ROE forecast. We believe that that 12% ROE for this year is something reachable. I mean, it's not on the optimistic side. What are the factors that could affect negative, positive that 12%, obviously cost of credit. How the provisions behave is key. And as we mentioned, we think that we are reaching the peak of the credit cycle and the customer clients that we mentioned before, we are managing those customers.

So, we believe that the next semester -- the second half of the year is going to be a better performance and will allow us to grow a little bit faster our portfolios. Consumer grades are going to grow and are going to give us additional income and the pace of deterioration is going to be slower. So we think that that forecast of 12% ROE is reach and is reasonable due to the current situation of the economy and the Bank. The other fronts, the efficiency fronts, the fees, all of them we will keep working and there will be -- we think in line of our expectations. Regarding the cost of fundings, let me pass that question to Jose Humberto.

Jose Humberto Acosta, Chief Financial Officer

Thank you, Juan. I want to compliment just one additional point of the answer of Juan regarding the NII and how we will reach the return on equity. Just a number, we are expecting to close in terms of provisions this year at a level of 3.5 Colombian pesos, that will help you to calculate how we are going to reach that return on equity and that increase of NII.

Regarding cost of funding, yes, we made extra efforts not only this semester, we began that process a year ago, trying to moving to funding cost -- keeping cost of funding. Today, we are expecting almost a flat cost during the second half of the year. We are not expecting a reduction on the cost of funding, because interest rates right now is a kind of plateau, maintaining the same level as you hear Juan Pablo, we don't expect a change in the Central Bank interest rates.
So that's the reason why we expect that the NIM will compress at the end of the year 20 basis points and that is because the repricing of the assets. But we will maintain the cost of funding at the same level, with the same composition 75% from retail and 25% for other sources of funding.

Third question

Thiago Bovolenta Batista, Analyst at ITAU.

Yeah. Hi, guys. Good morning and thanks for the opportunity. I have basically two questions, The first one is a follow-up on the cost of risk. Can you indicating to us how much you were expecting for next year with this big jump in the cost of risk for the year, probably, we will see a much of decline next year. But what is the level that you believe is feasible for the cost of risk for next year?

And the second question is about the banking fees. Looking to the numbers in the press release seems that the banking fee decline a lot this quarter about 20% Q-over-Q and also 20% year-over-year. What exactly caused this drop? There is any accounting change in this line to explain this big drop in banking fees?

Jose Humberto Acosta, Chief Financial Officer

Thank you, Thiago. Regarding your first question. We are foreseeing a cost of risk of next year in between 1.9 to 2.0. We have to highlight that five years or seven years ago our cost of risk were at around 1.5. But now, when we are moving more towards to have more consumer loans, the new standard for the Band of cost of risk for the long -- for the medium-term will be to be in the range of 1.7 to 1.8. That means that next year will be dropping but not at the level that we supposed to have as a standard that maybe we will reach that level in 2020.

Regarding Bank fees, we have basically huge level of transactions in our call centers and also we increased the level of corresponding agents. That explains that we increased almost 70% our cost of maintaining those channels, but we don't see immediately on the income side. That explains. But as we mentioned on the speech, you have to take in consideration that the number right now in 7% annual basis and we expect to close 7% to 8% or 8% to 10% at the end of this year. But the explanation is basically because we had two items in which increase, again, call centers and the Bank agents.

Fourth question

Andres Soto, Analyst at Santander

Good morning, everyone. Thank you for your presentation and the opportunity to ask questions. My question is related, again, with the cost of risk and your guidance for 2018. This -- in my view is the main difference between the guidance that you provided in the first quarter result with the one that we -- you are giving now. And what I would like to understand is, what changed over the past three months that make you so much more conservative in terms of the provision in expenses that you will need to make in 2018. Is it related to the large corporate cases, it's something else in your structural portfolio. What are the downside risk to these number to achieve even higher level in 2018? Thank you.

Jose Humberto Acosta, Chief Financial Officer

Thank you, Andres. What happened is, let me explain in four different buckets. In consumer, you see an improvements. So we don't expect an increase. In SMEs, you see that the numbers we thought that were below that level that we are having today. So that is the first deviation that we see in terms of provisions, but we are not foreseeing in terms of quality of the loan portfolio. So we foresee a better vintages, behave of vintages, but we see the bunch or the level of provisioning will maintain on SMEs.

In terms of large corporates, as Juan mentioned, we expect a slight increase of provisions. What happen is with the rest of corporates in which we saw a slight deterioration that impacted in our teams of provisions. So
short, is basically on the corporate side we saw a deviation in terms of the corporate of loans. And SMEs, we thought that it was -- it would improve, but nothing of that happened. So we -- the process of recovering on SMEs will take more than that the expected time at the beginning.

**Juan Carlos Mora, Chief Executive Officer**

Andres, and let me complement Jose Humberto's answer with something that the loan growth has been slower than we expected. So the cost of credit or the relative cost of credit increases because of that. And since we expect a better pace during the second half of the year, that will probably -- improve the cost of credit because of volume is going to have a better performance during the second half.

**Fifth question**

**Alonso Garcia, Analyst at Credit Suisse**

Hello. Good morning, everyone. Thanks for taking my question. And my question is regarding loan growth. As you mentioned you have been gaining some decent market share over the past couple of years. My question is how sustainable is this loan growth outperforming the system in the coming years? And for how long do you think you can continue growing strongly within your existing client base? And my second question is regarding OpEx. How sustainable do see the OpEx growing in the low single digits and what is your target for the next two years, three in terms of efficiency ratio? Thank you.

**Juan Carlos Mora, Chief Executive Officer**

Thank you, Alonso. We think that the loan growth it's -- is sustainable in the future. As we mentioned already several times, the economic activity is going to be favorable and that helps a lot. But also we believe that we are in the condition of taking advantage of that economic activity.

On the commercial side, we have improved our origination process, growing on our customers, as you mentioned, has been our strategy, a very successful strategy and we will keep moving in that direction. Since we have the largest customer base in Colombia, which is around close to 9 million customers and in the other country for 2 million. So we believe that we have target a small amount of those customer base and we are improving the products, we are understanding better the behavior of our customers. So on the retail side, we think it's achievable and we will keep moving on that direction.

The commercial -- on the commercial side, even though this could seem counterintuitive, SMEs for us is going to be a very good source of our future growth. Our customer base on that -- on SMEs is big. The -- having reached the peak and taking into account the cycle is going to be better. SMEs, again will be a source of growth for us. In terms of OpEx, your second question, we believe that we are able to grow expenses around inflation in the coming years. So we believe that we will be able to improve our efficiency ratios to reach our target of 46% in -- around 2020 --- in 2020 -- 2021 and we believe that the programs and the structural gains that we are having on costs will allow us to reach that level.

**Jose Humberto Acosta, Chief Financial Officer**

And complementing the answer of Juan, the rationale for reducing the efficiency ratio in the last five years were reducing costs. Today, we feel comfortable with that achievement and the rationale for the next two years to increase the efficiency or to have a better efficiency, that would be on the income side with a combination of better margins, better loan growth portfolio that would be achievable and that's the reason why we believe that we will get the level of 47 as -- 46, as Juan mentioned.

**Juan Carlos Mora, Chief Executive Officer**

No. We finished with that answer. We can move to the next question. Thank you.
Sixth question

Sebastian Gallego Betancur, Analyst at Credicorp Capital

Hi. Good morning, everyone. Thanks for the presentation. I have actually three questions. The first one is just a follow-up on OpEx. I know you talked about your targets. But can you provide a bit more color on any targets regarding optimizing branches, headcount, what's your expectation on that front?

The second question is regarding Panama. Can you provide a bit more color on the outlook on the operation of Panama. How are you dealing with the slower pace of growth and how do you expect to achieve better figures going forward? And my final question is just a follow-up also on asset quality. You mentioned in the previous call that the effect on NII coming from the adoption of IFRS 9 was somewhat mitigated with lower provisions and also IFRS with the expect -- with the provision expected model is supposed to take into account a better macro outlook. Why is the provision expenses continue to go up? Thank you.

Jose Humberto Acosta, Chief Financial Officer

Sebastian, regarding OpEx, we expect to, again, as with answering the last question. The efficiency, that will be a function of much better performance of the income. We are expecting to maintain again under inflation the OpEx increase for the next coming years with a combination of all different factors, not only labor costs, also operating expenses. So we don't have any specific view about that only the expenses growth.

Regarding your second question in Panama, yes, we see right now lower loan growth in Panama, but the positive news there is they're doing a big efforts to achieve better efficiency levels that actually they are getting with the cost control that helps. And the second front that Banistmo is helping us with a fee income ratio. It is a very good performance and they are reflecting and obviously we are replicated the same experience in Colombia we have retail in Panama. So that will be a matter of time. We expect that 2019 we will be able to reach that loan growth.

Regarding your third question. Yes. IFRS 9 you saw impact through all the banks in Colombia West, one-time impact on the balance sheet. So we don't foresee any particular deterioration because of IFRS 9, right now it's comparable and we -- again the 2.2% is based on the assumption that IFRS 9 is contemplated that expected losses.

Seventh question

Carlos Gomez Lopez, Analyst at HSBC

Hello. Good morning. One question is about -- really about what a good cycle looks like. So you are entering the period in which you think that things are going to improve. We're going to see more loan growth. But how much is that -- how much do you expect to grow over the next, let's say, three years to five year. How good can this cycle be? And I asked because when one looks at asset quality, one gets the perception that perhaps there was a more leverage in the previous cycle than we anticipated, and therefore, perhaps, the prospect for growth is now lower than it was in the past? What do you expect for the next three years to five years. Thank you.

Jose Humberto Acosta, Chief Financial Officer

Thank you, Carlos. Regarding your first question. We believe on CAGR the next three years, four years that the loan growth will be double-digit in the lowest end. We are maybe thinking about 10% to 13% in the next coming years.

Obviously, the basis of this year is low, so you'd see a very good performance on 2019 and you will be a more normalized performance on loan growth for 2020. But again that will be double-digit loan growth and that we
have capital and we have the source of funding to maintain that loan growth. And as Juan mentioned, that will
dilute the cost of risk because the level of provisioning will be different. Regarding the second question. Carlos, can you repeat please your second question, that one.

Carlos Gomez Lopez, Analyst
I limited myself to one, but actually since you offer me one, what's the impact of Basel III?

Jose Humberto Acosta, Chief Financial Officer
Okay. Regarding Basel III, yeah, the government is not releasing the final decree. We are just assuming that that would put in place the new two offers and they would put in place again a different calculation of the risk-weighted assets. So at the end of the day when we have the decree with the exact information, maybe we will go back with you. But our perception is non-material. The change in terms of the solvency ratio for Bancolombia, assuming part of the things that the regulator is saying regarding Basel III.

Juan Carlos Mora, Chief Executive Officer
Carlos, with the drafts that we have been discussing with the regulators. We don't see any material impact on Colombia. We will need to wait for the final regulation to come out but with the drafts that we have been discussing no material effect.

Eighth question

Yuri Fernandes, Analyst at JP Morgan
Thank you gentlemen for (inaudible) to ask some questions. I had a question on the effective tax rate for the quarter. It was very below like previous quarters and you mentioned a big proportion of Central America operations. But still, when we look to Colombia standalone, we see, like, the effective tax rate in Colombia at 17%. Can you provide more details on what has happened here, it was any kind of tax credit and what should be the tax rate for the rest of the year for you? Thank you.

Jose Humberto Acosta, Chief Financial Officer
Thank you for -- Yuri. What happened is, remember that we have a deferred taxes and at the beginning of the year, we made all the calculations for 2019 our deferred taxes, based on the assumption that the 37% statutory taxes, which is the current statutory taxes in Colombia. But remember then a year ago was released a tax reform in which the statutory tax for 2019 will be 33%. What we did in the second quarter was the re-calculation and adjustment of all the deferred taxes with the new tax base, which is 33, that's why you see a big impact of 17%. But the statutory tax or the tax for the 2018, as a whole, we'd be at around 30% to 32%. It is just an adjustment and where basically because of the provisioning that we had on the first quarter.

Ninth question

Natalia Corfield, Analyst at JP Morgan
Good morning all. So my question is with regards to your capitalization. And we saw that there was a decline this quarter. It was most explained by higher risk-weighted assets and your risk-weighted assets actually increase much more than the growth of your loan portfolio. So I am wondering what's behind the growth of risk-weighted assets, that's one. And within the same topic, there was also an increase in your regulatory capital. And you did not capitalize or earnings in this quarter, so I am wondering what drove the growth in the regulatory capital, which was offset by the higher RWAs. Thank you.

Jose Humberto Acosta, Chief Financial Officer
Regarding, Natalia, your first question, what happen with the risk-weighted assets. It's a combination of two factors. First, the loan growth in consumer, which is higher. You saw the numbers that was 70%. And the second regarding our securities portfolio to volatility increase, so the DV01 increase and that was the reason the risk-weighted increase. The VAR increased because of the volatility. So that consumes more capital. That is the explanation. Regarding the return on -- your second question was focused on?

Alejandro Mejia, investor relations officer

Retained earnings.

Jose Humberto Acosta, Chief Financial Officer

Retained earnings, we -- as you mentioned the peak impact was in the first quarter, basically because of IFRS 9. Our expectation is to, again, to maintain the same capital level based on the assumption down one-third of our net income annual basis that would be a dividend and we will retain two-thirds. That is why our guidance is to maintain that Tier 1 10% to 11% for the whole year.

Tenth question

Jose German Cristancho, Analyst at Davivienda Corredores

Good morning. Thank you. My question was related to OpEx, so it has been answered. Thank you.

Eleventh question

Jorge Umana, Analyst at BNP Paribas

It was already answered. Thank you.

Juan Carlos Mora, Chief Executive Officer

Okay. We will like to thank you for your participation on this conference call. We are confident that the economic improvement in Colombia and the developments that are happening in Central America will improve the results of the Bank during the second half of the year. We expect that that on average creates results in line with we just explained to you today. So, we will hope to see you on our conference call for the third quarter of 2018. Thank you and have a good day.

Operator

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