

November 10th, 2016

Transcript - 3Q16 Earnings Conference Call

Supervielle Third Quarter 2016 Earnings Call Opening Remarks

Operator

Good morning and welcome to the Grupo Supervielle Third Quarter and Nine Months 2016 earnings call. A slide presentation will accompany today's webcast, which is available in the Investor section of Grupo Supervielle's investor relations website, www.gruposupervielle.com. As a reminder, all participants will be in listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. As a reminder, today's conference call is being recorded.

At this time, I would like to turn the call over to Ana Bartesaghi, Treasurer and IRO. Please go ahead.

Ana Bartesaghi

Thank you. Good morning everyone and thank you for joining us today. Speaking during today's call will be Patricio Supervielle, our Chief Executive Officer and Chairman of the Board of Directors and Jorge Ramírez, Vice Chairman of the Board of Directors. Also joining us is Alejandra Naughton, Chief Financial Officer. All will be available for the Q&A session.

Before we proceed, I would like to make the following Safe Harbor statement. Today's call will contain forward-looking statements and I refer you to the forward-looking statement section of our earnings release and recent filings with the SEC. We assume no obligation to update or revise any forward-looking statements to reflect new or changed events or circumstances.

I would now like to turn the call over to our CEO, Patricio Supervielle.

Patricio Supervielle

Thank you, Ana. Hello everyone and thank you for joining us today. It's a pleasure to welcome you to Supervielle's third quarter earnings conference call.

If you're following the presentation, please turn to **Slide 3**.

Overall, we are pleased with the results for the quarter. We delivered strong profitable growth, reporting a 160% sequential increase in net income as we continue to successfully execute our growth strategy leveraging the capital raised in our IPO last May. This has driven above-industry loan growth, exceeding the rate of inflation.

With our strong focus on risk management, we began to reverse the asset quality deterioration experienced in the previous quarter following the contraction in consumers' disposable income in a more challenging than expected economic framework.

Results were underpinned by a resilient net interest margin despite lower interest rates, and strong operating leverage as we continue to increase the number of loans per branch.

Jorge will provide more color on this in a few minutes. But before that, I will discuss the overall economic environment, financial system trends and our loan performance.

Turning to the macro on slide 4, I will provide a brief overview of where we are now, and the outlook.

2016 remains a transition year. Inflation is trending down after reaching a monthly high of 6.5% last April, and we now anticipate inflation of 1.5% by December and 37% for the year. Lebac rates continue to decline following the same trend.

According to the most recent Market Expectation Survey, GDP is expected to contract by 2% this year. We remain optimistic that sustainable growth will resume during 2017 and expect GDP growth for next year of 3.2% with inflation of 19%.

Now, let me review the financial sector in slide 5. Loans to the private sector were up 6% quarter-on-quarter, with corporate loan growth slowing down to 7% from 12% last quarter, while retail loans expanded by about 5%, similar to the prior quarter. Compared to the same quarter last year, system loans increased 31%.

Industry deposits, in turn, rose 6% QoQ and 37% YoY. However, loan and deposit growth remained below inflation.

The Badlar rate – the Buenos Aires deposits of large amount rate – continued its declining trend experienced since the end of June dropping 440 bps sequentially to 22.2% by the end of September, following the reduction in the Lebac rate.

Although the current economic environment is still volatile, the outlook for 2017 calls for improvement and we are well positioned for when this occurs. Argentina is under-banked and under insured, which provides an attractive growth opportunity for us. Additionally, new market friendly regulations and rational monetary policy all bode well for the sector.

Moving on to our performance on slide 6, we expanded our total loan book by 13% quarter-over-quarter and above the rate of inflation. This is the second consecutive quarter we grew at double the industry pace as we continue to leverage our higher capital base and attractive value proposition.

Let me highlight that on-balance sheet loans rose almost 16% QoQ as we continued to reduce loan securitization in line with our funding strategy.

Corporate loans remained the primary growth driver, representing 44% of our total loan portfolio, up from 41% in the previous quarter and 35% in the first quarter of this year, before our IPO. Note that higher margin SMEs and middle market represent about 63% of corporate loans. Consumer finance loans also performed well maintaining their share of total loans.

Looking at our loan segments in more detail on slide 7, Corporate Loans were up 76% YoY. On a sequential basis, corporate loans increased an impressive 23% - more than triple market growth, largely driven by continued strong demand for trade finance and US dollar denominated loans. These loans represented 13% of the total portfolio from 3% in the third quarter of last year.

Similar to the second quarter, growth was driven by our ability to leverage existing client relationships, coupled with an attractive value proposition to achieve our goal of increasing loan size per client. Our ability to offer clients a one-stop model where we service their financial needs with our broad product selection, while at the same are attentive to their specific requirements is contributing to our good performance. Importantly, a key differentiating factor is our ability to provide flexibility and shorter time to cash.

Retail loans were up 22% YoY, with sequential growth picking-up 6% and continuing the improvement we started to see early July. Actually, retail loans almost doubled the sequential growth rate achieved in the previous quarter, when senior citizens, which represent 58% of retail loans, were strongly affected by the sharp price increases in consumer goods, resulting in weaker loan demand.

Finally, Consumer Finance loans were up 13% QoQ. And, we are starting to see early signs of a reversal in the asset quality deterioration experienced in the prior quarter, affected by a contraction in consumers' disposable income.

While growth over the recent two quarters has been largely driven by loans to larger corporations, as the economy recovers and we execute on our strategy in 2017, we expect to drive growth in our higher margin clients such as SME, Middle Markets, as well as Retail and Consumer Finance. We will be leveraging our higher capital base to maximize the opportunity we see in these markets.

I will now hand off the call to Jorge Ramírez, who will review our funding, P&L and guidance. Please Jorge, go ahead.

Jorge Ramírez, Vice Chairman of the Board

Thank you Patricio, good day everyone.

Moving on to funding on slide 8, we drove above-industry growth of our deposit base, posting a 10% sequential increase, up 47% YoY. The yearly growth was mainly driven by savings accounts which were up 75% and time deposits that grew 36%. We saw a similar trend quarter on quarter.

Low-cost demand deposits represented 56% of our total deposit base (40% in savings accounts and 16% in checking accounts) at the close of September. This is 3 percentage points down from seasonally high second quarter levels which benefited from the 13th salary. Retail deposits, at 54%, continued to represent a high share of total deposits reflecting the importance of our low-cost deposit network franchise.

Note that the 104% net loan to deposit ratio this quarter reflects our strategy to primarily fund loan growth by reducing our holdings in Central Bank notes – or Lebacs - given their declining interest rate, before starting to take higher-cost institutional deposits.

Turning now to slide 9, gross financial margin was up 20% sequentially, exceeding the 13% sequential loan growth in the quarter.

This good performance reflects the contribution from average interest earning assets which grew 17% above the 10% increase in average interest bearing liabilities. At the same time, the average rate on personal loans, which rose 495 bps, partially offset the lower average interest rate on corporate loans. By contrast, interest rates on average liabilities declined faster than those on average loans.

Note that gross margin benefited from a 270 basis point reduction in the average interest rate paid on liabilities following the decline in the Badlar rate.

Importantly, the higher margin was achieved despite the increase in the regulatory reserve requirements which rose 3% for time deposits and 5% for current accounts.

Moving on to slide 10, net service fee income was up 14% QoQ, a pick-up from the 3% sequential increase reported in the previous quarter. Higher volume in checking and savings accounts, coupled with the elimination of regulatory restrictions on fee pricing last September together with higher fees from debit and credit cards were the main drivers behind this performance.

Note that in September we finalized negotiations with the Province of San Luis following their request to modify certain terms and conditions under the financial agency agreement of 1996. We signed an amendment to the agreement confirming our commitment to the development of the Province of San Luis.

As part of this amendment, Banco Supervielle relinquished its right to receive an “agency” fee from the Province of San Luis for any services rendered as financial agent of the Province starting July 1, 2016. As a result, Financial Agent fees charged to the Province fell to 4 million pesos this quarter from 25 million in the prior quarter.

Income from insurance activities was up 18% QoQ as Supervielle Seguros continues to post rapid growth. Starting last September, Banco Supervielle and Cordial Compañía Financiera started to self-insure and therefore no longer contracted life insurance coverage for new flow of loans and credit cards.

Now turn to slide 11, as we review asset quality. We are seeing some early signs of reversal in asset quality deterioration after the spike experienced in the previous quarter when the consumer finance segment was impacted by the challenging and volatile economy which significantly contracted consumers’ disposable income.

As a result, loan loss provisions declined 12% quarter over quarter to 261 million pesos with our cost of risk decreasing to 3.7% this quarter from 5.0% in 2Q16.

We remain committed to continue implementing additional collection and preventive actions to mitigate further asset quality deterioration, while maintaining our strict credit policies.

Moving on to expenses, on slide 12. We achieved a significant improvement of 960 basis points in the efficiency ratio bringing it down to 62.5% in the quarter as we continued to drive loan growth, leveraging our operating base, while reducing cost of funding.

The 41% YoY growth in administrative expenses was largely driven by the salary increases from collective bargaining agreements implemented in 2Q16. Higher non-personnel expenses including advertising and publicity to support our loan growth, as well as leases, security service expenses, maintenance, and taxes among others also contributed to the increase.

Sequentially, expenses were up 3%, or 38 million pesos, as higher personnel expenses – including severance payments incurred in line with ordinary course of business – advertising and other expenses more than offset the 29 million pesos sequential decline in taxes.

On a quarterly basis the employee base remained unchanged.

Now, turning to profitability on slide 13. Net income rose 126% year-on-year and 160% compared to the second quarter of the year as we continued to execute our profitable growth strategy.

As anticipated, ROAE began to normalize this quarter reaching 28.6% after the temporary dilution experienced in 2Q16 resulting from the capital raised in the IPO. Let me also highlight the improvement in ROAA which more than doubled sequentially reaching 4% in this quarter.

In terms of capitalization, as shown on slide 14, we repaid 123 million pesos of high-cost holding company debt in the quarter and expect to continue redeeming existing notes at maturity.

Remaining funds at the Holdco today, of around 900 million pesos, are invested in low-risk, short-term local mutual funds which posted a 29.4% annualized return in the quarter, thus taking advantage of tax losses carried forward in this company. After paying down debt we expect to maintain excess liquidity of 620 million pesos to fund growth.

The consolidated pro-forma Tier 1 ratio adjusted from 13.5% in 2Q16 to 12.6% at the close of September, given the significant loan growth delivered in the quarter. Please bear in mind that this ratio only includes 50% of the Central Bank regulated subsidiaries' third quarter profits, which will be 100% computed as Tier 1 capital as of October 31, 2016. Normalizing 100% of those profits as of 3Q16, this ratio would have reached 13%.

Also note that as the loan portfolio continues to build up and seasons and we continue to gain operational leverage, we expect accrued net income to increase our Tier 1 capital base to support future growth.

Moving on to guidance, as you can see on Slide 15 we reaffirm the guidance provided in our 2Q16 earnings call, the first as a publicly listed company.

This includes:

- Total loan growth for the year ranging between 47 to 57%,
- An NPL ratio between 3 to 3.2%,
- NIM ranging between 17 to 20%,
- An efficiency ratio of 66 to 71%,
- With Net income between 1.2 to 1.4 billion pesos, and
- The Tier 1 ratio to range between 11.5% and 12.5% by year-end.

Looking into 2017, we expect a decline in the inflation rate and a positive impact on economic activity as a result of the inflation targeting monetary policy announced by the Central Bank, together with market friendly regulations.

The market expectation and ours is for GDP in 2017 to grow by 3.2%, with inflation of approximately 19% for the year. While we are in the process of working on our budget for next year and will be providing guidance for 2017 in

our 4Q16 earnings call, let me share with you some high level insights as to how we see 2017 at this time given the current circumstances.

Based on these macroeconomic assumptions and the continued implementation of our growth strategy, we expect to see a pick-up in loan demand. We anticipate loan growth in real terms to be above 2016 levels, both for the industry and ourselves.

We also expect lower NIMs for the industry next year, in line with the drop in the inflation rate. Given our portfolio mix, we believe we are in a good position to defend our NIM levels. Finally, while we are in the process of reviewing our selective investment plan for 2017, we expect to continue leveraging our operational base.

We are now ready to take questions please. Operator, go ahead.

QUESTIONS AND ANSWERS

Operator:

Thank you. We will now be conducting the question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Our first question today comes from Carlos Gomez of HSBC. Please go ahead.

Carlos Gomez:

Hi, good morning. A couple questions; first, although you are not giving precise guidance, you said that you expect real loan growth next year for the system. Again, maybe not for you; but what do you expect for the system as a whole? My second question refers to your agreement with the province of San Luis. If I understand correctly, you are now receiving a monthly payment for the services provided. I imagine that there are other terms in the agreement. Can you give us an idea about what else you have agreed with the province? Thank you.

Jorge Oscar Ramírez:

Hi, Carlos. Thank you for your question. Regarding your first question, we're still working on the figures for next year, but definitely we expect, as opposed to what happened this year, loan growth to be above inflation rate for the overall industry, and in our particular case, we're expecting that growth to be in real terms higher to the growth in 2016 and still to be above what the industry has. We'll be providing more guidance when we have the fourth quarter earnings call.

Regarding your question about the agreement with the province of San Luis, essentially, the other things that we have included in the agreement has been—we have agreed to expand our presence in the province; we have agreed to grant the line in favorable conditions to small- and medium-sized companies in the province; and we have agreed to grant the line for deleveraging current—some of the public employees of the province. That has been essentially the bottom line of the agreement.

Carlos Gomez:

Can you lend directly to the province?

Jorge Oscar Ramírez:

Actually, no. Lend directly, no. I mean, a couple of considerations here. In the first place, San Luis is a cash-rich company and it has been traditionally a cash-rich company for the past 20 years. I mean, they have lots of money to be collected from the Government as a result of a lawsuit they won in the Supreme Court. So, it's not a province that has been traditionally requiring loans from banks, okay, as opposed to many other provinces in Argentina.

Second, Banco Central highly restricts loans to provinces, so provinces can fund themselves primarily through the capital markets essentially, that's the way they finance.

Carlos Gomez:

Thank you very much.

Jorge Oscar Ramírez:

Okay.

Jorge Oscar Ramírez:

Pleasure.

Operator:

Once again, if you would like to ask a question, please press star, then one.

We have a follow-up question from Carlos Gomez of HSBC. Please go ahead.

Carlos Gomez:

Hi. Thank you. If nobody's asking, then I would like to follow up with a question on your capital level. You have a guidance of AR\$11.5 million to AR\$12.5 million. You expect to grow in real-time next year, which suggests probably more than 20%, so there could be some capital consumption next year. I understand you haven't done the numbers. What would be your tolerance? What is the minimal level of capital that you would like to operate with, and would you contemplate subordinated debt or other mechanisms to reinforce your capitalization?

Jorge Oscar Ramírez:

Our targeted long term targets for Tier 1 capital is 10%, and total capital 12% ratio. Given our current projections, we do not expect to require any further capitalization, essentially because as we start deploying our capital, we start growing our portfolio and we're seeing our operational leverage, the profitability we generate. It's going to be enough to support our growth of our capital base, so we're fairly confident and fairly comfortable with our level of capitalization.

Clearly, if the growth rate both in the industry and after loan growth rate starts to grow at a much faster pace than what we are currently expecting, then we might have to ask for further, or look for other alternatives, but there's plenty available. We could issue subordinated debt, we could start securitizing part of our portfolio, or we could go back to the market. I mean, we're pretty open to all of those alternatives.

Carlos Gomez:

Just to clarify those 10% and 12%, those are ratios for the Bank or at the consolidated level for the group?

Jorge Oscar Ramírez:

Those are on a consolidated level for the group.

Carlos Gomez:

For the group? Okay.

Jorge Iscal Ramírez:

Yes.

Carlos Gomez:

Okay. Thank you very much. By the way, that includes the payment of dividends or you are not contemplating dividends at this point?

Jorge Oscar Ramírez:

We're not contemplating dividend payments at this point, essentially because we're planning on keeping growing by reinvesting profits.

Carlos Gomez:

Okay. Thank you so much.

Jorge Oscar Ramírez:

Pleasure.

Operator:

The next question is from Alejandra Aranda of Itaú. Please go ahead.

Alejandra Aranda:

Hi. Good morning. I was wondering if you could give me more color on the corporate sector on the growth dynamics, where you're seeing more interest, more demand, and specifically what type of products are your clients demanding on that sector. Then on the Retail side, do you think we're going to see a pickup on this segment in the next few quarters? Basically, that would be it.

Jorge Oscar Ramírez:

Thanks, Alejandra; good morning. Okay. Regarding your first question, we're seeing business dynamics in terms of public works, construction, business, and logistics. These are essentially sectors with which we have a very good presence through different types of products. When it comes out to logistics or even construction, remember that we're one of the leaders in the market. We're the largest issuing portfolio in the Argentine market, so these are companies that demand lots of leasing.

In any event so far, the bulk of the growth in the corporate portfolio, as it has happened in the industry, has come from dollar denominated loans. A substantial portion of it has to do with trade finance loans; we're still seeing some demand there. Going forward with the public works and construction and lots of infrastructure investments that we're seeing starting to pick up substantially in this second half of the year, and we expect that to continue in 2017. The financing of those public works, which is something that we have traditionally done, is one of the lines of avenue growth that we're expecting.

Regarding your second question, in terms of growth loan in the Retail sector, clearly with high inflation rates and the impact that that had on disposable income, we saw some sluggish demand, particularly in the first half of the year. It's starting to pick up during the third quarter. With inflation coming down and interest rates starting to come down,

this is a sector that we expect that loan demand is going to return to much higher levels than what we have seen this year, next year.

The other thing you have to take into consideration is that, particularly in the case of our customer base, both in the Consumer Finance Company and in the Bank, this is a sector that's much more focused in the level of the installments and the relationship in installments, the monthly installment that they have to pay on the loan in relative terms to their monthly revenues or their monthly income. So, if interest rates come down, you can maintain the same level of relationship within the monthly loan payment that they have to meet compared to their monthly salary or monthly income, you can lend more money to the same customer base, okay, and that's another part of the growth that we're expecting.

Alejandra Aranda:

Okay. Thank you very much. That was very helpful.

Jorge Oscar Ramírez:

Pleasure.

Operator:

As a reminder, if you would like to ask a question, please press star, one. Our next question comes from Jorge Kuri of Morgan Stanley. Please go ahead.

Jorge Kuri:

Hi. Good morning, everyone, and congratulations on the results. I have one question on asset quality; clearly a big improvement versus the second quarter. Can you give us a bit more color on how things are progressing on that front so far in the fourth quarter? Thanks.

Jorge Oscar Ramírez:

What we're seeing in the fourth quarter so far, Jorge, is more or less the same trends that we saw in the third quarter. I mean, it's stabilizing, the lagged delinquency it has stabilized, particularly in the Consumer Finance Company at a higher level than what we had prior. But, if you compute everything together—interest rates we're charging on those loans, the cost of funding that has come down substantially, and the impact of the asset quality—it's a much more profitable spread and it's a much more profitable loan portfolio than what it was in the first half of the year. So, we believe that the trend that we've been seeing in terms of stabilization and reduction in terms of the cost of the risk for the fourth quarter will stay on course.

Jorge Kuri:

Thanks. If I may add something along those lines. Your coverage ratio allowances over NPLs is roughly in the 85% to 90% level. Is there an internal interest from you guys to have that at or above 100% as most of your peers do, or you're comfortable with that level; and if so, at what point do you think you're going to be able to bulk up those reserves?

Jorge Oscar Ramírez:

As we have discussed before, Jorge, our long-term goal is to reach 100% coverage for the Group, but in the next two to three years. Probably for the rest of the year we expect the coverage to be in the high 80s and we will grow gradually there as we continue to improve our operational leverage and profits.

Jorge Kuri:

All right. Thank you, Jorge, and congrats again.

Jorge Oscar Ramírez:

Pleasure. Thank you. Thank you.

Operator:

As a final reminder, please press star, one if you would like to ask a question.

There appears to be no further questions at this time. I'll now hand the call back over to Ana Bartesaghi for closing comments.

Ana Bartesaghi:

Okay. Thank you all of you for joining us today. We appreciate your interest in our Company. We look forward to meeting more of you over the coming months and providing financial and business updates next quarter. In the interim, the Team remains available to answer any questions that you may have. Thank you and enjoy the rest of your day.

Operator:

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

Ana Bartesaghi

Thank you for joining us today and we appreciate your interest in our company. We look forward to meeting more of you over the coming months and providing financial and business updates next quarter. In the interim, the team remains available to answer any questions that you may have. Thank you and enjoy the rest of your day.