

August 10th, 2017

Transcript - 2Q17 Earnings Conference Call

Supervielle Second Quarter 2017 Earnings Call Opening Remarks

Operator

Good morning, and welcome to the Grupo Supervielle Second Quarter 2017 Earnings Conference 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 Investor Relations Officer. 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 Ramirez, 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. Good morning everyone and thank you for joining us today. If you're following the presentation, please turn to Slide number 3.

We reported robust results which underscore our focus on driving profitable growth, with comparable net income doubling year-on-year. NIM expansion and fee growth along with efficiency gains were the main drivers behind this good performance. Keeping our emphasis on profitability, we continued to expand higher-margin loans while making inroads in developing an integral relationship with corporate customers with the goal of becoming their principal bank. We maintained a vigilant focus on credit risk while also attracting low cost retail deposits. Based on our solid performance to date and our optimistic economic view of Argentina's economic recovery, which we expect will boost higher loan demand, we are increasing our loan growth and net income guidance for the year. I will discuss this in more detail shortly.

Turning to the macro environment on Slide number 4, we are encouraged by the economic recovery underway in Argentina. We saw a strong pick-up in economic activity in the quarter while inflation is trending down from 41% last year to a market consensus estimate of 22% for the year. Industrial activity, as per the INDEC was up 6.6% year on year in June, marking the highest reading in almost six years on the back of growth in motorcycles, automobiles, construction, as well as in metal mechanical and cement sectors, among others. Consumer demand continues to lag behind, showing a diverse behavior,

with motorcycles, real estate and automotive growing at high double digits ranging between 35% to 50%. By contrast, white goods increased only 13%, while apparel along with food & beverage contracted 4%.

Moving on to the Argentine financial sector in Slide number 5, system loans to the private sector rose almost 41% year on year and expanded 12% sequentially following the seasonal deceleration experienced in the first quarter. Quarter-on-quarter industry growth was largely driven by corporate loans, up almost 16%. U.S. dollar-denominated system corporate loans were up 34% while promissory notes rose 11%. Retail loans in turn expanded 9% sequentially. System deposits remained flat for the second consecutive quarter but were up 38% year on year. Growth was driven by Argentine peso savings account deposits, which more than offset a 25% decline in U.S. dollar deposits, primarily due to lower U.S. deposits in the public sector.

Turning to Slide number 6, our focus on driving profitable growth resulted in year-on-year loan growth of 51%. Sequentially, loan growth showed a seasonal acceleration growing to 8% from 6% last quarter, and I will discuss this in more detail shortly. Aligned with our strategy of focusing on the dynamic SMEs and middle market, we continued to drive growth in these segments, which increased their share over total loans to 65% from 59% in fourth quarter 2016.

Now turning to Slide number 7, growth this quarter was mainly driven by a solid performance in our corporate and retail portfolios. As anticipated in our previous call, corporate loan growth accelerated in this quarter by almost 10% sequentially and 78% year on year, mainly driven by the pick-up in factoring loans. This is our largest product in corporate loans and the second largest on our total loan book. Additionally, strong demand in foreign trade finance and U.S. dollar denominated loans continued to support growth in our corporate loan book.

We also delivered sustained growth in retail loans, up 8% sequentially and 32% year on year, underpinned by personal and credit card loans. Let me also highlight the good performance in mortgage loans. Although coming from a very low base, mortgages almost doubled quarter on quarter, which we believe is a clear indication of consumers' improving medium and longer term view on the economy. Consumer finance loan growth rates, however, decelerated to almost 3% from 19% in the previous quarter, but still expanded 60% year on year. Weak consumer demand, which is still lagging the economic recovery, resulted in softer supermarket traffic as price sensitive consumers are temporarily turning towards wholesalers. We expect this trend to reverse as consumer sentiment improves. Let me highlight the strong increase in gross intermediation margin for this segment, which was up 174% year on year and 8% quarter on quarter.

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

Jorge Ramirez:

Thank you, Patricio. Good day everyone.

Moving on to funding on Slide 8, we continued to drive strong growth in our deposit base, up 55% year on year and 10% sequentially, well above market levels. Our loan to deposit ratio declined 360 basis points sequentially to 99%, driven by strong growth in checking and savings account balances. Year-on-year, growth in U.S. dollar denominated deposits, up 226%, reflects the success of the tax amnesty program.

As shown on Slide 9, our robust retail franchise continues to support quality funding with a greater share of low cost retail deposits. Retail and senior citizen deposits represented 58% of our total deposit base at the end of the quarter, up over 200 basis points from last March. The share of non or low interest-bearing deposits increased to 64% from 56% in the first quarter, while institutional deposits declined their share by 130 basis points to 24%, supporting cost of funding.

Turning to the P&L on Slide 10, total NIM expanded 110 basis points sequentially to 19.8% in second quarter '17 despite the 20 basis point decline in the Badlar rate in the period. The key drivers behind this were: first, a 50 basis point expansion in peso-denominated loan portfolio NIM to 23.9%, which represented over 80% of total loans; and second, an 840 basis point increase in investment portfolio NIM to 18.7% driven by better returns and higher volumes, reflecting our increased liquidity position, as discussed before. Gross financial margin for the quarter was up 64% year-on-year and 11% sequentially.

Average interest-bearing liabilities, driven by significant growth in special checking accounts, rose above average interest earning assets while average interest rates earned fell following the declining trend in the Badlar rate. This good performance reflects the contribution from average interest earning assets, which grew 11% above the 8% increase in average interest bearing liabilities, including low or non interest-bearing deposits. While the average interest rate earned on assets decreased 10 basis points, gross financial margin benefited from an 80 basis point decline in rates on interest bearing liabilities.

Moving on to Slide 11, our net service fee income ratio improved sequentially by 30 basis points to over 31% in the quarter. Net fee income growth accelerated to 14% quarter on quarter and 55% year on year. Re-pricing along with robust dynamics in checking and savings accounts, credit, and debit card loans following the elimination of regulatory restrictions on fees last September, along with a growth in non credit-related insurance products were the main drivers behind higher fees. Note that the mandatory reduction in merchant discount rates effective last April resulted in a sequential decline in credit and debit card fees that was more than offset by non-credit insurance products. This good performance in non-credit insurance also drove a 3% sequential increase in income from insurance activity, reversing the negative trend experienced over the past two quarters when regulatory changes affected credit related insurance.

Now, moving on to asset quality on Slide 12, it is important to reiterate that we maintain a vigilant focus on asset quality, closely monitoring our business risk profile given the segment seasonality we experience. The year-on-year improvement in NPL ratios of our retail and corporate loans resulted in a 20 basis point decline in the total NPL ratio. These two business segments account for 87% of our total loan portfolio.

Sequentially, the NPL ratio remained stable at 2.9% quarter on quarter despite the seasonal deterioration in consumer finance loans. This segment accounts for 13% of total loans. Retail banking in turn posted another sequential improvement in NPLs, down 30 basis points, while corporate NPLs remained unchanged. Remember that asset quality in the consumer finance business tends to show higher delinquency rates in the first half of the year and then adjusts down as salary bargaining agreements catch up with inflation, improving consumers' disposable income and their ability to repay these loans. In fact, 30-days lagged delinquency in personal loans already started to show some improvement in July.

Cost of risk declined from 5% in second Q16 to 4.2% this quarter, but increased from 3.9% in the first quarter this year. This resulted from higher non-performing loans driven by the seasonal delinquency in consumer finance that I just mentioned and a 100 basis point increase in the coverage ratio to 88%. While cost of risk continued to reflect the seasonal factors, we feel confident we are on track to meet our full-year guidance.

Turning to expenses on Slide 13, the efficiency ratio improved to 65% in the quarter from pre-IPO levels of 73.8% in first quarter '16 and 67.5% in the first quarter this year. Administrative expenses were up 7% quarter on quarter, mainly reflecting wage increases from the collective agreement implemented at our non-banking subsidiaries since April, a 2% increase in our headcount in indirect commercial channels to support growth, particularly at our sales force, and a 15% increase in non-personnel expenses, mainly reflecting higher leases, security services and maintenance expenses, along with higher lower advertising and marketing expenses.

Please turn to Slide 14 to review profitability. We are pleased that net income for the quarter more than doubled to 580 million pesos year on year and rose 52% quarter on quarter, as we continue to successfully execute on our strategy. Excluding three non-recurring items that benefited comps, our bottom line increased 202% year on year and 22% quarter on quarter. Results for the quarter benefited from a one-time gain of 73 million pesos from the sale of two non-core assets, a property and a subsidiary. Sequential comps also benefited as first quarter '17 was penalized by a 50 million pesos foreign exchange loss in connection with a medium term note issuance that quarter. As anticipated, we achieved an increase in return on average equity, up to 31.2% in the quarter from 21.8% in first quarter '17. Remember that net income is seasonally weaker in the first half of the year and improves in the second half.

In terms of capitalization, as shown on Slide 15, the consolidated pro forma Tier 1 capital ratio adjusted to 11.6% from 12% in first Q17 as we continued to drive loan growth. Funds at the holdco available for further capital injections in subsidiaries reached 805 million pesos at the end of June. These funds were invested in low risk, short-term financial instruments which posted a 21% annualized return in the quarter. This also allows us to take advantage of tax losses carried forward at the holding company level.

I would now like to turn the call over to Patricio to discuss guidance, and then we'll open the floor for questions. Thank you.

Patricio Supervielle:

Thank you Jorge. Moving on to our outlook on Slide 16, based on the solid fundamentals we are seeing to date, we are optimistic in Argentina's economic recovery, which we expect will boost higher loan growth demand. This along with our solid performance to date and the seasonality of our business, where results accelerate towards the second half of the year, we are increasing our guidance for loan growth and net income for 2017. We now expect loans to expand in the range of 43% to 50% from our previous target of 38% to 45%. Our net income guidance is now 2.2 billion pesos to 2.4 billion pesos, from our previous 2.1 billion pesos to 2.3 billion pesos expected range, which calls for an implicit return on average equity ranging from between 28% and 30%. Our cost of risk, NIM, efficiency, and Tier 1 ratios remain unchanged.

We are now ready to take questions, please. Operator, please open the line for questions.

QUESTIONS AND ANSWERS

Operator:

Thank you. We will now be conducting a 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'd 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.

Our first question is from Frederic De Mariz of UBS. Please go ahead.

Frederic De Mariz:

Good morning everyone. Thank you for the call and for the opportunity. I have a couple of questions, the first one on the capital base. We saw our—your plan to raise more shares in the future. I wanted to get a sense from you in terms of timing, what are you looking at in terms of triggers to launch the capital raise, and also I understand that the amount that is approved is quite high, so I wanted to understand if you're considering doing only a partial capital raise or if you're looking at the full amount? In other words, I'd love to know what you think would be a comfortable Tier 1 ratio going forward, so that's on the capital.

The second question I have is on asset quality. We saw an increase in the cost of risk. You commented a little bit on asset quality and on growth. I just wanted to understand from you what are you seeing, what are you hearing from your clients, be it individuals or companies, and is there any sector or any region that's concerning you? I just wanted to understand that increase in provision. Thank you.

Jorge Ramírez:

Okay, morning Frederic. Thank you for your questions. Regarding the first question, at this time based on market conditions and what we see our needs, we see our needs to be for the next year, so our intention is not to raise the full amount that we filed. The reason why we filed a larger amount is because we're not yet a well known issuer for SEC, so that requires us to make a filing that we could cover two to three-year period, and remember that that filing also includes potential debt issuances, not just equity. At this stage, we're definitely not thinking in terms of raising the full amount of capital that we have to require for regulatory and legal reasons as for approval. That definitely is not what we have in mind.

In terms of the timing both monetary and the markets, I think that the markets might have entered into avoidancy mode regarding the election outcome, so we're currently monitoring that. We also hope that all these things that are happening with the U.S. and North Korea might go away. I mean, they're clouding out a little bit the horizon, so again, since we don't need the money, we don't need the money definitely to achieve our goals for this year, we have good timing in terms of—or good leeway in terms of deciding when to go to the market.

Regarding your second question, I mean, there are a couple of things to be considered here. First of all, clearly the economy is in a revamping mode, and you have sectors that have really already rebounded very heavily, like—and the good thing is that it's not just sectors that have to do with medium and high income level economic segment level population, but also

from people from low, medium income levels, for example, the growth that we saw in sales of motorcycles, these are not the large BMW motorcycles that a high income person would buy, these are 250cc or below that motorcycles, so that goes to the medium, low income segments, and that rebound—that grew by 50% first half of this year compared to last year, so it's a pretty impressive rebound.

What we're seeing lagging in terms of economic activity in the first half is essentially staples, like beverages, food, that kind of thing, clothing, those sorts of things. But, as inflation comes down and disposable income improves, definitely we expect a much, much better second half of the year for those economic segments compared to what the performance was in the first half. All those things considered, our drivers of optimism regarding performance of NPLs for the second half of the year are why we are reaffirming our full-year guidance in terms of cost of risk, so we expect things to continue to improve. If you go back to the seasonality that the consumer finance portfolio has, it should call for a much better second half in terms of NPLs.

Frederic De Mariz:

That's good, thank you very much. That's very clear, thanks.

Operator:

Thank you. The next question is from Ernesto Gabilondo of Bank of America Merrill Lynch. Please go ahead.

Ernesto Gabilondo:

Hi, good morning Patricio, Jorge, Alejandra and Ana, and congrats on your results. Three questions on my side. The first one is in terms of NIMs. I just want to know how you see them evolving, how much NIM pressure are you expecting from lower interest rates? My second question is related to expenses. As you mentioned, the increase was mainly due to the wage increases with the collective agreement. Where do you see this line growing in the next quarters, and what should we expect for the rest of the year? I don't know if it should be more in line with inflation. Finally, my question on the political side, I would appreciate to hear your view on what's your perception on next elections. Thank you.

Patricio Supervielle:

Okay. Do you want to take it?

Alejandra Naughton:

Ernesto, it's Alejandra speaking. I will start with your question regarding expenses. Yes, as you mentioned, the evolution of our expenses are expected to be above inflation because of all the initiatives that we have connected with the deployment of our strategy. We are focusing on launching initiatives that always are connected with generation of earnings, so even though you will see administrative expenses growing above inflation, they will also come along with an increase in earnings, so looking forward for this year, we will see administrative expenses some points above inflation.

Jorge Ramírez:

Okay, regarding the question about NIMs, I mean, we're already seeing and we will be seeing for some time pressure on NIMs. One of the good things that we have is that we have a mix that protects us better from NIM pressure essentially, because approximately 50% of our total loan portfolio comes from loans to individuals, and within that, the bulk of our mix comes from personal loans as opposed to credit cards, so those are high yield loans and long-term fixed rate in pesos. But, in any event, despite any pressure on NIMs, our expectation going forward is that volume growth in Argentina should more than compensate any drop in NIMs or any pressure on the NIMs, because again it's—I think the whole industry has an operating leverage here in the sense that size of balance sheet is quite low in relative terms to the size of the economy, so this is multiplied for a couple of magnitudes, orders of magnitude in terms of the increase that it should have going forward. Again, I think it's a trade-off between absolute spread and size of volume, and our expectation going forward is that the volumes are going to more than compensate any fall in NIMs.

Patricio Supervielle:

Yes Jorge, I would like to add on the way to—this is Patricio. The way also to defend NIMs is to continue our strategy of trying to become principal bank of our clients and which—corporate clients, which will allow us to increase the—continue increasing the low-cost of checking account funding. I think this is also important that—please Jorge, do you want to add to that?

Jorge Ramírez:

No, no, but on the political side.

Patricio Supervielle:

The political side, yes.

Jorge Ramírez:

I mean, the assumption under which we're working is that Cristina Fernandez de Kirchner will be elected to the senate. I think that the question remains whether or not—what's the percentage that she's going to get in this election, and whether or not the government will win the election this Sunday, and most importantly, in October. The—and I think we should define this following election in terms of the national scope and the Province of Buenos Aires in itself. At the national level, we don't have any doubt at all that the government is going to perform very, very well and win the election. When you add all the votes and the different provinces, they're going to have a very, very good election, and they're going to outpace their followers or the next coming from the opposition for probably double-digit—for a double-digit difference.

On a local level, one possible scenario—it's a very tight race, and still all the polls, all the credible polls that you can see fall within the marginal statistics of error, so they are showing a tie, so it could go either way but it's going to be—in our expectation, it should be a tight difference. In October, the likelihood, even if the government loses for a couple of points the election next Sunday, which is the primary and it's mandatory, we're still confident that they might reverse that situation for the October national election because of the level of rejection that Cristina Fernandez de Kirchner still generates in part of the population. She has approximately between 60% and 70% negative perception.

What does this mean for (inaudible)? Cristina being in the senate, what does this mean for politics going forward? We don't believe that that is per se a negative thing. In a sense, Cristina in senate, it's a divisive period for the opposition, so it's preventing the parties starting to come together around one candidate. Probably what this will mean for the government is that they will be able to continue reaching agreements with governors of different provinces. I mean, they don't say this publicly, but governors in the provinces in private, they would like the government to win against Cristina for a small difference because that will rule out Cristina as a potential future candidate for national elections with riding power, but will still give them the ability to be able to bargain with the government and negotiate that.

We understand that there's some nervousness in terms of what is Cristina doing here again, but I think we should focus on the fact that this is a midterm election and the votes that Cristina might get in this—next Sunday's election are probably all the votes she's ever going to get going forward, unless the government really performs very poorly in the next two years, which is not our scenario.

Ernesto Gabilondo:

Very detailed, much appreciated. Thank you.

Jorge Ramírez:

Pleasure.

Operator:

Thank you. The next question is from Jorge Kuri of Morgan Stanley. Please go ahead.

Jorge Kuri:

Hi, good morning everyone. Congrats on the numbers. Wanted to get your impression on the competitive environment for credit pricing. We've seen now all of the publicly traded banks report very strong credit growth numbers, most north of 20% growth in real terms, which is certainly a lot. I do understand the penetration of credit is very low, but just wanted to hear what are you seeing in terms of price competition. Are you bumping against your competitors, or it's still a pretty cozy environment where you're working with your current clients and don't really have to go outside to get growth? Thank you.

Jorge Ramírez:

Morning Jorge, thank you. I mean, we're still competing—let me step back a little bit. We never ceased to compete against our competitors. This was always a highly competitive environment, even though it was a closed market, and the reason for this was that in the past, we had—I mean, competition was for all the fishes swimming in a smaller pond. I think the name of the game now is we're starting to swim in a larger lake, and we still see—we're still seeing good opportunities for us to continue growing with our existing customer base. Again, as you mentioned yourself, leverage in Argentina is pretty slow—pretty low, both at the corporate level and at the household level. I read a report, I don't know if it was one of your reports, Jorge, but the average debt in households in Argentina is \$1,800. For a country with \$15,000 of GDP per capita, that's inexistent, so we still have plenty of room to continue growing.

Again, we're going to see spreads coming down and interest rates coming down as inflation comes down, which is a logical process; but if you look at past history in Argentina, the deposits, every time we had deposits, interest rates for deposits in real terms positive, domestic savings started to grow and in hand with that, credit is starting to grow.

Again, it is a highly competitive environment, but—it's still a competitive environment in which we have not yet reached a growth wall in which the growth is no longer profitable. We put a lot of focus on profitable growth this past quarter and we continue doing that, and we believe there is still huge potential for future growth. I mean, look at investment levels, look at mortgages. I mean, mortgages are practically inexistent in Argentina. The level of investment in the past decade or so by companies has been also practically inexistent, so all this is starting to happen and will continue happening in the next two to three years, so.

I think in summary, my bottom line message is despite the increased competition, we feel pretty confident that all the growth that not just us but in general the financial industry is going to be able to deliver is going to be very profitable growth.

Jorge Kuri:

Thank you, and congrats again.

Jorge Ramírez:

Thank you.

Operator:

Thank you. As a reminder, ladies and gentlemen, it is star, one if you would like to ask a question.

Okay, it appears we have no further questions at this time. I'd like to turn the conference back over to Ms. Bartesaghi for closing comments.

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. Goodbye.

Operator:

Thank you. Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time and thank you for your participation.