

August 24th, 2018

Transcript - 2Q18 Earnings Conference Call

Supervielle Second Quarter 2018 Earnings Call Opening Remarks

Operator

Good morning and welcome to the Grupo Supervielle Second Quarter 2018 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 Chairman and 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 3**.

This was a very difficult quarter. Our results were significantly impacted by the drastic and sudden changes in the macro environment resulting in a sharp decline in attributable net income for this quarter and our expectations for the year.

In this context, we took decisive actions, including:

- First, we further tightened credit standards throughout the Company,
- Second, we began to implement cost cutting measures across the board,
- Third, we decided to streamline and change the management of our consumer finance operations. As announced yesterday, effective today the consumer finance units of Grupo Supervielle, which include: Cordial Compañía Financiera, Espacio Cordial de Servicios, Tarjeta Automática, and the recently acquired car lending business MILA, will be led by Mr. Juan Martin Monteverdi, current CEO of Espacio Cordial de Servicios. By combining the four companies under a unified leadership, we seek to drive increased operational efficiency, accelerate the offering of a wide range of consumer products, enhance customer experience, and increase cross selling. Consequently, Mr. Carlos Depalo has stepped down from his role as CEO of Cordial Compañía Financiera and Tarjeta Automática and leave the Company.

We remain fully focused on executing our strategy and closely monitoring economic dynamics in order to best execute our strategy with the rapidly changing environment.

Despite the near-term challenges we are facing, our core business remains healthy, with asset quality in SMEs and Middle Market at historically low levels. Deposits performed well and continued to expand exceeding the growth of our loan book. We are convinced of the resilience and strengths of our franchise, as well as our policies and practices and believe the growth potential for the financial sector in Argentina remains unchanged.

Turning to slide 4, the macro was impacted by internal and external factors, the Argentine currency experienced a sharp devaluation of around 50% along with a spike in inflation and a steep and sustained increase in interest rates.

As shown on **Slide 5**, our macro assumptions for 2018 set at the beginning of the year were aligned with the market consensus and included:

- GDP growth of 3%, with inflation continuing its declining trend reaching 19% for the year.
- The Badlar rate, which is the benchmark rate for the Argentine financial system, and the monetary policy rate, were expected to follow inflation downward trend.

- And the foreign exchange was anticipated to reach 22 by year end.

Following the significant changes in the macro backdrop experienced in the quarter, we have adjusted our assumptions for 2018 now expect GDP to contract by 0.3% this year and inflation to increase to around 32%.

In this context, the Badlar and Montetary policy rates are anticipated to be at 29% and 35%, respectively at year end with the FX rate at 30 pesos per dollar.

While we have taken actions to adjust to this new macro environment, it was not enough to fully mitigate the initial impact on our results which led to a performance well below our expectations.

Moving on to the Argentine financial sector, on slide 6. In this context the financial system has proven its resiliency, based on high liquidity levels and good capitalization.

Importantly, system deposits in the quarter expanded over 18% QoQ, above loan growth of 15%.

We experienced a similar trend with deposits up 36% and loans increasing 14% sequentially.

On a FX neutral basis, our loan book rose 5% sequentially, while deposits were up 24%.

Turning to slide 7. As we just explained the FX devaluation had an impact on the growth rate of the loan book resulting in a 14% sequential increase. Peso denominated loans rose 7%, while US\$ denominated loans declined 3%.

Of note, we further lowered our exposure to the Consumer Finance Segment to 11% from 12% in first quarter following the tightening of credit scoring standards in this segment starting early in the year.

Let me also highlight the growth in share of retail loans that was partly driven by the growth of the mortgage loan portfolio. This was a mix of new loan origination and inflation adjustment methodology.

Moving on to slide 8, Corporate and retail loans rose more than 13% sequentially, while consumer finance loan growth posted a continued deceleration up 3% in the quarter.

Turn to slide 9. This page demonstrates the quality of our loan portfolio in terms of economic activity, atomization and collateralization.

Our portfolio is well diversified across a broad range of economic sectors.

Moreover, the top 10 and 20 borrowers account for 10% and 14%, respectively of our loan portfolio.

Also, 49% of our SME and Middle Market portfolio is collateralized.

Finally, over 67% of the retail portfolio is tied to payroll or pension clients.

Before handing the call over to Jorge Ramírez, I want to congratulate him on his new role as CEO effective September 1st. As Chairman, I will still be actively involved in the business, which remains my only business. I will continue working very closely with Jorge as we have done for the past seven years. And this includes meeting with the investors and participating at conferences when appropriate.

Jorge will now review our funding, P&L as well as guidance. Please Jorge, go ahead.

Jorge Ramírez, Vice Chairman of the Board

Thank, you Patricio, good day everyone.

Moving on to funding on slide 10, let me highlight the solid growth in our deposit base, with double digit growth in both retail and corporate deposits. Peso denominated deposits increased 31% QoQ, while those denominated in US\$ were up 5%. The share of FX deposits remains below 30% of total deposits.

The loans to deposits ratio was closer to 100% this quarter.

Moving on to the P&L on slide 11, Net Interest Income plus Net Income from Financial Instruments and exchange rate differences were relatively flat sequentially and up 42% YoY.

This was mainly due to the following factors:

- First, our banking business reported softer than expected margins from lagged loan repricing given the sudden and sustained rise in interest rates. This is a temporary effect as we expect this business to deliver improved performance in the coming quarters as longer-term assets are repriced to the new environment.
- These sharp hikes in interest rates took an even higher toll on our consumer finance business.
- Lastly, our trading desk had a short position on FX at the onset of the AR\$ devaluation in addition to lower than anticipated trading results, which impacted our bottom line this quarter.

These factors brought about a 40 basis points sequential decline in our Net Interest Margin slipping to 19.2% in the quarter. Net financial margin which include the exchange rate differences and results from forward transactions declined 250 basis points in the period to 17.4%.

Please turn to slide 12. The tables on this page show the repricing dynamics of our assets and liabilities.

Based on the repricing dynamics of our portfolio, our banking business is anticipated to capture increased interest revenue from rate hikes.

This is due to average peso denominated liabilities which reprice in 45 days while peso denominated loans reprice in over 240 days.

Moving on to slide 13, Net Service Fee Income continues to perform well, showing a sequential increase in the net service fee income ratio of 200 basis points.

The acquisition of online trading platform Invertir Online last May, complements the value proposition for our customers and has added new stream of revenues to our company.

We plan to extend this platform to other investment services. Consistent with our digital transformation strategy, this acquisition clearly represents a qualitative leap in the value proposition for our customers and extends significant new opportunities to the InvertirOnline customers who will become part of the Supervielle platform.

In terms of asset quality, on slide 14, an unfavorable macro environment continued to affect consumers' disposable income. As a result, the consumer finance book was the main contributor to the higher cost of risk and NPL creation reported in the quarter.

While retail and corporate NPLs each rose 20 basis points sequentially, they still remain at historically low levels.

Looking deeper at our retail book, the 90 days plus delinquency ratio of the blended book stands 100 basis points below the NPL ratio. This is explained by the 67.5% share of retail loans tied to payroll or pension customers, which results in clients remaining current with us despite being non-performing with other institutions in the system.

Looking at the consumer finance asset quality on slide 15, the vintage analysis is showing an improvement in credit quality of new loans starting March of this year under tighter credit scoring.

Lagged delinquency for this segment, also shows an improvement suggesting a change in trend since June.

Consumer finance NPLs as of July remained flat compared to the prior month, for the first time since February 2016

These metrics are the results of the different measures taken over the past two quarters to manage credit quality.

Now moving on to expenses, on slide 16, while expenses increased slightly above inflation, our efficiency ratio increased to 66% from 59% in the first quarter impacted by flat operating revenues.

We are implementing cost cutting and containment measures which we expect should result in a percentage increase in expenses of around mid to high 20s this year, below expected inflation level.

Please turn to slide 17 to review profitability.

Attributable comprehensive income for the quarter declined 11% year-on-year and 36% sequentially. As we just explained, this was due to:

- The increase in cost of funds in consumer finance and higher loan loss provisions in this segment,
- Lagged repricing in NII in our banking business, which is a temporary effect, and
- The impact from the short position on FX at the onset of the AR\$ devaluation along with lower than anticipated trading results.

ROAA declined to 1.8% from 3.3% in the first quarter, while ROAE fell to 12.6% from 20.6% in 1Q18.

Turning to capitalization on slide 18, we reported a consolidated pro-forma TIER1 Capital ratio of 13.1% at the close of the quarter, compared with 15.8% in March.

During the quarter we made a capital injection of 861 million pesos at Banco Supervielle and acquired MILA and Invertir Online.

Funds at the holdco amount to 2.0 billion pesos, available for future capital injections.

Moving to guidance on slide 19. Based on the challenging macro dynamics which has significantly changed our macro assumptions for the year and impacted results for the quarter we are resetting our guidance for 2018.

We took several corrective actions already discussed in this presentation regarding cost cutting measures, even more stringent credit standards, and streamlining of the consumer finance operations. The latter is expected to result in go-forward annualized savings of between 100 to 150 million pesos, with a negative impact of between 30 to 50 million pesos in 2018 as a result of reorganization charges.

And while the repricing dynamics of portfolio is anticipated to capture increased interest revenue from rate hikes, we believe this will be insufficient to offset the weak results of the the second quarter, and the impact of higher cost of funds and lower loan growth in consumer finance.

In this context, our new guidance is as follows:

- We now expect loan growth to range from 40 to 50%, compared to our original guidance of 45-50% expansion
- Cost of risk is anticipated to range between 4.6 to 5.1%, from 4.1 to 4.5% before
- NIM guidance remains unchanged at 18 – 20%
- While we anticipate expenses for the full year to grow below inflation, we are now expecting the efficiency ratio to range from 59 to 63%, from 55 to 59%
- As a result of these factors, we are lowering attributable comprehensive income guidance to the range of 2.9 to 3.3 billion pesos, from our original guidance of 4.0 to 4.3 billion pesos.
- Finally, also reflecting the capital allocated to the two recent acquisitions which was not included in our original guidance, the Tier 1 ratio is now expected between 12 to 13%, from our earlier range of 14 to 15%.

In sum, we had to navigate through very difficult events this quarter and we expect a softer economic environment for the rest of the year. However, we remain optimistic regarding the long-term prospects for Argentina and for our industry. We have a strong and resilient franchise that we believe has been even further strengthened with our recent acquisitions and we are well positioned to capture higher profits as the economy normalizes.

I would like to take this opportunity on behalf of the Board and the entire executive management team to thank our shareholders for their continued support. We are now ready to take questions. Operator, please open the line for questions.

Q&A

Yuri Fernandes:

Thank you gentlemen. I had a question on your commercial asset quality. It has misbehaved, it has been running at 0.5 NPLs. But my point here is how worse this can get and if your cost of risk guidance contemplates that? Notably, when you look to the new NPL formation of the commercial loans, they are increasing about seven times versus last year, and like your cost of risk guidance from 4.6% to 5.1% is below what you had on the second quarter. So my question is, does it look to you that it's a bit optimistic, the cost of risk guidance? And I have a second question on your margins at loans. I know that margins remained somewhat behaved, but when you look to some products we see personal loans and credit card loans heading to decline in this quarter. That was a surprise to me because like given the higher rates I was expecting the lines to have a higher loan yield. Can you explain what's happening here, how you are seeing the repricing of loans, how long it may take for that through to the margins? Thank you.

Jorge Ramirez:

Okay. Regarding the first part of the question, the commercial—the increase in the cost of risk guidance that we provided includes marginal—further deterioration in our commercial portfolio. The bad loan formation, I mean, we're coming from such low levels of delinquency rate that any income and even if it's—if it's a 20 basis points

increase, which in overall is not significant in terms of bad loan formation, it's a doubling of the bad loan formation. So I think it's a matter of the level from which we're starting and where we're going.

We don't believe that these figures are optimistic. I mean, based on the current macro assumptions that we have, if the recession worsens, then we might be having a different type of conversation, but given our current macroeconomic assumptions, which are in line with the market consensus, we believe that the cost of risk guidance that we have provided should be enough to cover and normally it's too optimistic.

The other thing you have to remember are essentially two things. Number one is, we work a lot in terms of operational cost of financing, and our past experience in other crisis is that these are portfolios that tend to behave significantly better than other types of loans to companies. The second thing you have to bear in mind is that 49% of our SMEs and Middle Market portfolio is collateralized. So that also gives us sufficient protection in case of a worsening.

Regarding the margins decline, you are—I mean, the increase in the non-performing loan portfolio in a sense plays a role here because that's a portfolio that has stop yielding, the refinancings also come at lower interest rates, that also has an impact on this. So I think those are the things that explain the lower margins that you saw.

Yuri Fernandes:

Okay, thank you.

Jorge Ramirez:

Pleasure.

Operator:

Thank you. Our next question comes from the line of Gabriel Nobrega with Citibank. Please proceed with your question.

Gabriel Nobrega:

Hi everyone and thank you for the opportunity. In the press release you have stated that you will become more selective in your origination process and you have only revised your loan growth guidance to 40%. I just want to understand since you were becoming maybe more selective in your origination, could there maybe be a downside risk to your loan growth guidance? And I'll make a second question afterwards. Thank you.

Jorge Ramirez:

Okay. You have to bear in mind that guidance is in peso and the valuation plays a role here. So because we have approximately 25% of our loan portfolio is in U.S. dollars, so that plays a role. Second, we have already accrued very high growth rates year-on-year so that also plays a role. Finally, remember that we have a very high share in the factoring business and factoring tends to pick up substantially by the end of the year as a result of year-end sales for holidays. So I think the combination of those two things make us believe that the 40% to 50% range is adequate.

In any event, again, as I explained in my—the answer to a prior question I believe from JP Morgan, this is based on our macroeconomic assumptions. So if the recession worsens then we might have to review this. I think we're an institution in which we'll have to continue looking at the evolution of things quarter by quarter because the institutions remains very fluid and dynamic.

Gabriel Nobrega:

All right. And as for my second question, I remember that on previous calls you had said that you had a plan of reaching a coverage ratio of around 100% by 2020. I just want to understand if that is still the plan or maybe do you want to reach a coverage ratio close to those levels sooner. Thank you.

Jorge Ramirez:

That's a permanent discussion we have and we still maintain our guidance in terms of that we're going to reach coverage by the end of next year. But if we can anticipate that, we'll definitely try to do that.

Gabriel Nobrega:

All right, that's very clear. Thank you.

Operator:

Thank you. Our next question comes from the line of Fernando Suarez with AR Partners. Please proceed with your question.

Fernando Suarez:

Hey, thanks for taking my question. I was just thinking on the cost of risk that you posted this quarter and I see this should be declining deeply for the third quarter and the fourth quarter in order to meet the new guidance. And then I do my second question.

Jorge Ramirez:

Yes. Fernando, good morning. One of the things you have to bear in mind is that—I mean, we hit the brakes on the Consumer Finance business end of the first Q, and part of that is already showing in terms of the growth of that portfolio and how that portfolio is diluting itself as a percentage of our total loan book. We expect that trend to continue going forward. So the NPL ratio and the cost of risk at the end there is a blend. These portfolios tend to go sour pretty quickly so as we tighten credit standards the new loans are behaving and the loans being originated are behaving substantially better than the prior portfolio. So as we move towards the end of the year that should play a role. When you look at the delinquency of the bank they are substantially lower than our overall NPLs.

So the combination of all these factors, and I explained also in the presentation, in July, for the first time since February 2016 we saw the peso amount of NPLs in the Consumer Finance portfolio flat compared to the prior month. So we're still monitoring the situation it's too early to say that the worse is over and we believe that measures we're taking combined with the changes and streamlining we're doing on this business are going to help us to bring asset quality even more under control going forward. Again, we expect the combination of all these factors should be enough for us to reach the cost of risk guidance that we're providing.

Fernando Suarez:

Great.

Operator:

Thank you. Our next question comes from the line of Carlos Gomez with HSBC Global Asset Management. Please proceed with your question.

Carlos Gomez:

Hi. This is Carlos Gomez from HSBC. My question is about the macro environment and what your expectations are for growth and for the exchange rate for the next two or three years. I realize it is difficult but I wanted to know what do you think are reasonable scenarios at this point? Thank you.

Jorge Ramirez:

That's a great question and it's—I mean, it's not an easy question to answer. We were having a couple of discussions with several economic advisors. I think that the average consensus and what we're working on is that it's going to look like a V-shape recovery but a V-shape that will remind you of a Nike logo rather than a victory V, okay? So it's a sharp downturn, the one that we're having now, and then start to recover going forward. I mean, just by the impact of a better climate, the impact of the harvest should have very important influence in the growth indicator next year. We've heard estimations from some economists that's saying that the drought costed us this year 8 billion dollars and less exports from the agri sectors and there's some estimations that this figure being minus 8 billion this year to be flat 11 billion next year.

So clearly there are things that we still don't know how they're going to turn out. All these questions regarding construction as a result of the recent judiciary scandals is still to be seen how that evolves going forward. But again, as we said, we remain optimistic in the medium and long-term in terms of the growth prospect for Argentina and especially for our industry.

Operator:

Thank you. Our next question comes from the line of Yuri Fernandes with JP Morgan. Please proceed with your question.

Yuri Fernandes:

Thank you, gentlemen, for taking again another question from me. I had just a question on capital here. I understand that the level of risk should be under pressure, like I guess the bottom of your guidance implying about 20%, 21% ROE for the coming quarters, the higher end 25% ROE and this is well below the loan growth base, like growing at 40%, 50%. But for the next year's it's also hard to see ROE moving close to the pace of loan growth so you should continue consuming capital. So my question is how are you seeing capital for the coming years and when do you anticipate meeting capital or you see maybe ROEs or maybe the pace of loans kind of converging with each other because to date 13% to Tier 1 ratio your situation is covered but I'm not totally sure if this will be the case in the coming two, three years. So if you can add some points on that would be very helpful. Thank you.

Jorge Ramirez:

We always said that around 11.5% would be the point at which we go back to the market to try to raise more capital. We still have other options prior to going to the market, which is issuing subordinated debt as a way of raising Q2. On the other hand, more than ROE I think that what you should look at is how much the net profit that we'd make as to our capital base going forward compared to the year-end net worth (phon) and because ROE is an average calculation and wide profit addition to net worth is probably a better way of looking at this. If you look at original guidance for this year we were thinking in terms of doubling our growth, and now we're talking of a growth of around—between 45% to 60% compared to last year. So that is more in line with the growth we're having in terms of credit growth.

So going forward, it will depend on if we are able to continue delivering the operational leverage that we had been delivering in the past quarters and we believe if the institution normalizes that should be the case and we're going to gain—by means of gaining efficiency which should gain profitability but also it's going to impact our ROE and returns levels higher.

Yuri Fernandes:

Okay, thanks. And best of luck for the coming quarters. Thank you.

Jorge Ramirez:

Yes. Thank you.

Operator:

Thank you. Once again, as a reminder, if you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate that your line is in the question 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 more questions.

There are no further questions at this time. I would like to turn the call back over to Ms. Bartesaghi for any closing remarks.

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, we remain available to answer any questions that you may have. Thank you and enjoy the rest of your day.

Operator:

Thank you. This concludes today's teleconference. You may disconnect your lines at this time. Thank you again for your participation, and have a wonderful day.
