

May 22nd, 2018

Transcript - 1Q18 Earnings Conference Call

Supervielle First Quarter 2018 Earnings Call Opening Remarks

Operator:

Good morning and welcome to the Grupo Supervielle First Quarter 2018 Earnings Call. A slide presentation will accompany today's webcast which is available in the Investors section of Grupo Supervielle's Investor Relations website at www.gruposupervielle.com. As a reminder, all participants will be in a 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.

Ana Bartesaghi:

Thank you. Good morning everyone and thank you for joining us today. Speaking during today's call will be Patricio Supervielle, our CEO and Chairman of the Board of Directors, and Jorge Ramirez, Vice Chairman of the Board. Also joining us is Alejandra Naughton, CFO. 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 Statements section of our Earnings Release and written filing with the SEC. We assume no obligation to update or revise any forward-looking statements to reflect new or change events or circumstances.

In accordance with Central Bank regulations, this quarter we have adopted IFRS. Know that for comparative purposes, changes in accounting policies were applied retrospectively to 2017 quarters and full year. In our earnings report filed yesterday, we have enclosed an Appendix with a description of principal differences between previous Central Bank GAAP and IFRS, along with the impact of different line items of financial statements of operation.

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 are following the presentation please turn to **Slide 3**.

Momentum continued in the first quarter of the year as we again posted strong results that underscore our profitable growth strategy. This was evident in sustained loan expansion exceeding system growth and solid deposit base. Operating leverage continues to drive further efficiency improvements and profitability gains. Our good business performance reflects the strength of our franchise and branch networks which we have been expanding over the years.

Turning to the macro on Slide 4, we continue to see an overall healthy economic environment in Argentina and during the quarter. Auto manufacturing was up 22%, construction 14%, cement 12%, car sales up 16% and motor sales 32%. By contrast, consumer demand lagged behind affected by persistent inflation driven by increases in utility prices. With a rise in the yield of the U.S. 10-year dollar treasury bond and a stronger dollar, the Argentine currency, like other emerging market currencies, was challenged during the period. Specifically for us, we saw the exchange rate hike to 25 peso per dollar and the monetary policy interest rate increased to 40%. The Badlar deposit rate, which is the benchmark rate for the Argentine financial system, rose from 22% at the end of the first quarter to 30% currently.

In light of tighter external market conditions early in the year, the Argentine government successfully placed a \$9 billion bond issuance, anticipated a third of the financing needs for the year. In an increasingly challenging international environment, the government has sought additional financial support by seeking a standby credit agreement with the IMF to reinforce the macro normalization and macroeconomic transformation program designed for Argentina.

Please turn to **Slide 5**. Despite current economic and currency headwinds, the long-term growth story for the financial sector in Argentina remains intact. The financial system remains healthy with deposits both in pesos and foreign currency experiencing usual seasonality, as you can see on the two cards on the left side of this slide. This was despite the 31% depreciation of the peso year-to-date.

The Argentine financial system is extremely liquid with a significantly low currency mismatch of 7.4% in terms of regular trade capital, the lowest level over almost two decades.

Please turn to **Slide 6**. Moving on, the Argentine financial sector systems loans to the private sector increased by 56% year on year and 10% sequentially above inflation. System deposits, in turn, grew 30% year-on-year and 11% in the first quarter of 2018. We delivered a solid performance and we continue to execute on our growth strategy, beating systems loans and deposit growth.

Turning to **Slide 7**, we reported strong growth in the quarter, expanding our loan book 62% year-on-year and 10% sequentially, exceeding system growth. In line with our strategy of becoming our customers' primary bank, we are focused on generating an attractive credit offering and building synergies between retail and corporate banking. This strategy is paying off with payroll customers now representing 33% of our retail portfolio. While the share of corporate loans remains stable, we saw a mix shift to SMEs and middle market loans which represented 67% of corporate loans compared to 65% in fourth quarter 2017.

Please turn to **Slide 8**. We delivered high double-digit year-on-year growth on our loan portfolio. Corporate loans grew in line with overall industry growth in the quarter and remains a stronger growing segment year-on-year, up 74%. Our focus on higher margin SMEs and attention to their unique needs continued to drive lending in the corporate segment and was the main driver of loan expansion this quarter. With 45% of this portfolio collateralized and benefits to a more competitive export environment, this portfolio remains a strong credit.

Retail was the fastest growing segment in the quarter, up 12% sequentially, as we continue to drive growth in personal loans and credit cards. This was further supported by a good performance in mortgages, however, following the recent sudden steep increase in the FX rate and higher interest rates, we expect growth in this segment to slow in the near term. Nonetheless, we remain confident in the long-term growth prospects of this asset class, a key client acquisition tool for us.

By contrast, consumer loan growth slowed to about 3% sequentially. While we took a more conservative approach to growing our consumer finance business during the quarter, given resilient high inflation and increased utility prices, we remain committed to the long-term potential of this segment.

The acquisition of MILA, announced during the quarter, positions us well to continue capturing the attractive growth potential we see in the auto financing market, both in new and previously owned cars. We also see attractive synergy potential from the integration. New and previously owned car sales are robust growth segments and they are financing new asset classes Superveille and another example of how we are executing on our growth strategy which enhances gross selling opportunities across our company.

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

Jorge Ramírez:

Thank you, Patricio. Good day everyone. Moving on to funding on **Slide 9**, our deposit base increased 43% year-on-year, again exceeding industry growth and well above inflation. Sequentially, deposits remain relatively stable following robust growth in the 4Q '17 and the extension of tenures through the issuance of medium term notes this quarter. As a result, the long-term deposit ratio increased almost 120% from 108% in the previous quarter.

Please turn to **Slide 10**. Relying on our strong retail franchise and our strategy to grow cash management services, 56% of our total deposits bear either 0% or low interest rates. During the quarter, savings accounts stand out, growing 62% year-over-year, more than double the inflation rate, while checking accounts were up 30% in the period. By contrast, wholesale special checking account deposits fell 23% sequentially as we are replacing this funding with longer tenure MTNs.

Moving on to the P&L on **Slide 11**, net interest income plus net income from financial instruments increased 54% year-on-year and 7% sequentially. NIM has proven to be resilient at 19.6%, supported by higher yield on the Argentine peso and U.S. dollar investment portfolio, the results of higher cost of funds resulting from increasing the average Badlar combined with lower interest earned on loans as loans are typically repriced on a lag basis.

Moving on to **Slide 12**, we reported solid net service income growth up 20% year-on-year and up 5% sequentially. This was mainly driven by fee repricing and higher volumes in savings and checking accounts. In credit cards, higher loan volume slightly offset the regulatory reduction in merchant fees on debit and credit cards. Fee growth was also driven by higher sales of nonfinancial services, particularly in asset management and sales in Espacio Cordial.

Income from insurance activity was relatively flat sequentially as soft growth in gross written premiums in voluntary insurance products slightly offset the 16% decline in credit-related products.

In terms of asset quality, on **Slide 13**, blended NPLs remain relatively stable at 3.2% this quarter. The cost of risk, however, was up 30 basis points, sequentially, to 4.7% in the quarter, reflecting higher risk in consumer finance which represents around 2% of our loan book. This segment remains impacted by persistent inflation.

As you can see on the two charts on the right-hand side of the slide, lagged delinquency in our consumer finance business is generally following much the same trend observed in previous years but at higher levels than last year. In this context and taking a more conservative stance, in the first quarter we took the decision to tighten credit scoring standards to slow origination of consumer finance segment. Moreover, the anticipated increasing coverage to 89.7% this quarter, up from 88% in fourth quarter '17 put additional pressure on cost of risk. By contrast, NPL ratios in retail banking remain flat at 2.8% Q on Q while basically unchanged in corporate loans at 0.3%.

Now moving on to expenses on **Slide 14**, our efficiency ratio improved by 920 basis points sequentially to 59% this quarter. As we reported, an even steeper year on year improvement from 31% in the first Q '17 as we continue to drive operating leverage as the business grows. Sequentially, efficiency benefited from easier comps in personal expenses. The adoption of IFRS for first Q '18 and the restating of the past years to IFRS resulted in higher than average special termination agreements of approximately 233 million pesos in fourth Q '17 from early retirement for a group of eligible employees. This more than offset the sequential increase in wages to catch up with higher inflation and a slight increase in head count. This was mainly in our sales force for indirect commercial channels to support growth.

Efficiency also benefited from a sequential decline in non-personnel expenses with lower advertising, publicity expenses and taxes on dividend credit account transfers on the investment of the proceeds from the equity follow-on.

Please turn to **Slide 15** to review profitability. Attributable comprehensive income for the quarter was up 140% year on year and 58% sequentially. On a comparable basis, and excluding the higher than average special termination agreements in the fourth Q '17 mentioned earlier, attributable comprehensive income would have increased approximately 20% sequentially. Bear in mind that our bottom line is seasonally lower in the first half of the year than in the second half. Also note that comprehensive income includes the re-evaluation of real estate properties held for sale that were not taken into account under Central Bank GAAP, which this quarter amounted to 22 million pesos.

Return on average asset was up 110 basis points quarter over quarter to 3.3% or return on average equity rose to 20.6% from 15.3% in the fourth Q '17.

Moving on to capitalization on **Slide 16**, our consolidated pro forma Tier 1 capital ratio at the close of the quarter declined 15.8% from a 17.2% IFRS restated fourth Q '17 pro forma consolidated Tier 1 ratio, reflecting the strong loan growth in the period. This quarter we made net capital injections at Cordial Compañía Financiera and Tarjeta Automatica of 380 million pesos and 300 million pesos, each.

Funds at the Holding Company totaled 4.3 billion pesos at the close of the quarter available to fund growth. As we have mentioned in the past, these funds are invested in low-risk mutual funds and central bank notes, and also allow us to take advantage of tax losses carried forward at the Holdco.

Now, let me turn the call back to Patricio who will go over our guidance for the year and then we'll open the call for questions. Thank you very much.

Patricio Supervielle:

Thank you, Jorge. Looking ahead, we believe that despite current currency headwinds, the long-term growth story for the financial sector in Argentina remains on track, and all the recent steps taken by the government are in line with orthodox policies. In the current environment, which is one that we have successfully navigated in the past, we remain focused on driving healthy loan growth, mitigating risk and enhancing efficiency and profitability. Based on the current macro visibility, we believe we can achieve results within the range of the guidance we previously set out. Mindful of the rapidly changing macroeconomic scenario, we are closely monitoring the macro variables and how that impacts our guidance.

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

Operator:

Thank you. We'll now be conducting a question and answer session. If you'd like to ask a question, please press star, one from your telephone keypad and 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 that are using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. In the interests of time, please ask one question and one follow-up question. One moment, please, while we assemble the queue.

Thank you. The first question will be coming from the line of Alejandra Aranda with Banco Itaú. Please go ahead with your question.

Alejandra Aranda:

Hi. Good morning, Jorge, Patricio, Ale and Ana. Congratulations on the results. It was an impressive portfolio growth. I have three questions, if I may. First of all, I'd like to have more clarity on that 233 million personal expenses related to retirement settlement. If you could please tell us whether we should expect more of this to come in the future, how many people took this? Then my second question is basically I would like a little bit of color on your corporate portfolio, if you could give us a breakdown in terms of sector exposure that you have. My last question is regarding funding cost and the pressure that we saw this quarter. What should we expect going forward?

Patricio Supervielle:

Okay. Alejandra will take the first part of the question.

Alejandra Naughton:

Let me firstly start by telling you that the IFRS adoption is a material change in the accounting policies and so for comparative purposes we have applied that methodology retrospectively as is stated in the rules. So, as a consequence, those figures that we disclosed as 2017 were affected. So, the adjustments implied within IFRS adoption impact on valuation and also on reclassification. Valuation adjusts on the balances and P&L and probably you remember that we reported as of each quarter of last year the impact of those adjustments.

As was reported in the fourth quarter 2017, these adjustments had increased during the last quarter, reflecting a lower net profit for the quarter measured by IFRS methodology, and as you mentioned in your question, the main valuation adjustment was connected with a higher than average special termination arrangement in connection with early retirement for a group of eligible employees which amounted to approximately 220 million and corresponds to a number of employees of 48 people.

This kind of retirements are connected with the changes that the bank and the Group is carrying on as soon as our business is growing so we are changing the profile of some people within our teams and was a process that it was carried out last year so we do not expect to have further impacts on these kinds of special termination programs onward.

Patricio Supervielle:

Okay. Jorge is taking the second part of the question.

Jorge Ramírez:

Good morning, Alejandra. When you look at the breakdown, it pretty much remains the same one we had in the fourth Q. For us, agriculture, crops and fruit represents approximately 4.7% of the total corporate portfolio. Remember that we're not that much exposed to the soybean production. We're only indirectly exposed through sales of our chemicals, but we have recourse, in most of the cases, to the large suppliers, large corporate suppliers there. The bulk of our exposure is on zone which have not been affected by the crops and are different type of commodities mostly.

Then we have roadworks and specialized construction, that represent approximately 4.3% of the portfolio. Hipermarkets and supermarkets 3.6%. Automobiles is around 2%. Wine industry also 2%. So, it's pretty much atomized. As we said, 45% of our portfolio is collateralized so it is a pretty strong portfolio in terms of credit quality and resilience.

Moving to your last question, I think you were asking about deposits mostly. One the things that you have to bear in mind is that almost—we grew our NPL Notes by approximately 4.2 billion in the last year. Fifty percent of that happened in the first quarter of 2018, essentially because for us the cost of funds when you compound legal reserve requirements and our NPL deposits and all that, we always believe that it's much better for us to borrow with the same customer—same investors base, which is local institutional investors. Instead of raising deposits from them, 30-day deposits, it's much better for us to raise medium term notes, okay? That's what we did in the first Q following a substantial portion of our—or important portion of our need for the year. We issued 2.2 billion of medium-term notes in the quarter and that's what explains our relatively flat growth in deposits.

Operator:

Thank you. Our next questions come from the line of Ernesto Gabilondo with Bank of America Merrill Lynch. Please go ahead with your question.

Ernesto Gabilondo:

Hi. Good morning Patricio and all your team. Thanks for taking my call. Three questions from my side. The first one is about the business seasonality. Every quarter you experience higher provision charges. If we look to the cost of risk it was 4.6 of average loans which is above the guidance of 4.1%, 4.5% for the year. So, how do you see this ratio behaving in the next quarter? If it's really possible to think that if consumer salaries catch up with inflation, we could see delinquency rates improving.

My second question is if you can remind us how much of your loan portfolio and funding are at floating rates.

Finally, how much could high rates remain and not have an impact on the growth of the portfolio or asset quality? Thank you.

Patricio Supervielle:

Okay. Jorge is taking this one.

Jorge Ramírez:

Yeah. Regarding the asset quality, normally we tend to have a higher delinquency rate and higher cost of risk in the first half of the year and then that are normally above our guidance for the full year. So, the measures we're taking, as we explained during the call, is that we decided to start slowing down the growth in our consumer finance segment because we saw even before the current market turmoil, the past weeks' market turmoil, that inflation would remain resilient for pretty much of this year, so we decided to be a little bit more on the cautious side in terms of growth in this portfolio since this line of business has been the largest contributors to the NPL and the cost of risk for our company.

Going forward, probably we don't expect to see a decline in the second Q of this year. We more expect the declines in cost of risk figures to come in the second half of the year, again, following the traditional seasonality that delinquency has proven to have.

Remind me the second question was ...

Alejandra Naughton:

Fixed interest rate and ...

Jorge Ramírez:

Okay. You want to—Alejandra is going to take the second question.

Alejandra Naughton:

Okay. Ernesto, let me tell you about your question regarding the variable rates. Let's say that on our assets, by 50% of our assets correspond to corporate customers that mostly are priced at variable interest rates and very short tenures because that's our core product is factoring and factoring typically has shorter tenures.

On liabilities let's say that one-third of our liabilities are priced at the variable interest rates, and on liabilities side let me highlight that by 50% of our deposit rates do not bear interest rates.

Jorge Ramírez:

Then going to your last question, Ernesto, which is our outlook in terms of impact of the current level of interest rates. We believe that implicit in our assumptions is that as of July, as we enter the second half of the year we might start seeing between July and August some softening in the interest rates. We expect if that remains so growth for the year might continue to be more or less within our guidance in terms of loan growth.

In terms of the impact on credit quality that high interest rates might have, that would depend on the sector and on each specific company mostly because it's not only an impact or a matter of level of interest rates; it's also an impact of how much or how a company's net position will impact them in terms of the impact, whether it will impact more on the cost side or if impact them on the revenue side. Second is I think other variable is how much salaries are pressured as a result of these hikes in the interest rates going forward and how much that interest rate gets transmitted into the Consumer Price Index.

I think we still need a couple of more weeks or months to have a clear visibility in terms of what we expect. From where we're standing, we are reaffirming our guidance. We believe we are going to be within the guidance.

Patricio Supervielle:

I will add on also to what Jorge said. In terms of subsegment, on the corporate side there are—the impact of what is happening on the macro, well, for instance, one of the sectors is the oil and gas. It should be positively affected. We are financing SMEs suppliers of—captains of industries in the oil and gas. It should be positively affected because of good commodity prices but also because the devaluation translates into better cash flows in Argentina.

The same happened to regional economies which we are supporting in the Tucumán area where we are supporting clients that work with, for instance, lemons or sugar, sugar cane. The same happens in the regional economies of Mendoza where we have the bank number one, particularly in the wine industry. It also affects—devaluation has a positive effect. And generally speaking, with all suppliers of the agribusiness.

Then another sector which we are working on is the construction companies working for infrastructure, for public infrastructure. There, there should be relative slowdown with new bids. This is what the government announced. That will be negative but we expect that we'll be compensated by the new public and private projects.

So, therefore, it's a mix but positively—we think that the sectors that we are supporting, well, they should be sort of positively affected.

Operator:

Thank you. As a reminder, to ask a question today you may press star, one on your telephone keypad. The next question is coming from the line of Fredric De Mariz with UBS. Please proceed with your question.

Fredric De Mariz:

Good morning everyone. Good morning, Patricio, Jorge, Alejandra and team. Thank you for the opportunity. Two questions, two follow-ups actually. The first one, on the consumer lending side, you mentioned a few times that you were becoming a bit more cautious, that you were monitoring the situation very closely. What I wanted to hear from you is a bit of color. Are you seeing a change in the demand for consumer loans, is it more of a supply—on your side more of a supply change. You are deciding on your own to reduce the offering of consumer lending, consumer loans. With this question I'd like to understand if we should be expecting a higher cost of risk for that specific line. You showed in the slides that the 30-day, the early days past due loans are a bit higher in 2018, so should we be concerned about asset quality for consumer loans, or is it more just a reduction in the loan growth for consumer lending?

Then the second question, on the guidance, I understand that maybe to be too early to revise the guidance but I'd like to hear your thoughts about the specific guidance for margin. We are seeing that the Lebac is obviously much higher. We are forecasting that the Badlar will come up at some point. You're talking about funding costs rising. So, I'd like to understand how you think about maintaining your same guidance for margins and what are the moving parts for that specific line?

Jorge Ramírez:

Okay. Regarding asset quality and the consumer finance business, essentially what we see is that one of the things that we've known from the running of this business over the past years is that this has been a business that has been highly sensitive to the levels of inflation rate. Inflation rate makes disposable income less certain. It adds uncertainty on the person's disposable income. With the changes in the economic policy by the end of December of last year, we thought that we might enter into a scenario that inflation rate for the year would be higher. Therefore, what we thought is that in the consumer finance companies specifically, remember this is a consumer finance segment specific issue it does not affect our overall retail banking business in which we lend to people that most of them collect a monthly paycheck with us so it's a very different kind of business but different asset quality type.

Specifically in the consumer finance business, we are seeing supermarket sales being very heavily affected and people changing consumer habits, going more to wholesale supermarket chains than buying in large supermarket chains. Remember that 80% of our volume is still derived or comes from a partnership with Walmart, so as you have less traffic, you have a combination of lower demand, but on the other hand is we decided to voluntarily be more stricter and more tightened or tighten our underwriting scores, lending to better quality customers in order to protect the asset quality.

Going to the last part of this question, the 30 lag delinquency, you have a combination of things here. In general in terms of our cost of risk of this segment is it's being affected by, again, the high inflation in the quarter. It impacts this specific target of the population. The public utility price increases hits them harder than any other business segments that we have.

Second, we have been increasing coverage, so that also has an impact on the credit costs.

Finally, our lower growth rate also has an impact in terms of showing a higher percentage.

Going forward, we believe that, again, as we always say, the price—risk is fully priced in and it's reflected in the rates we charge so profitability in this business is in line with what we've been expecting it to be. Clearly, going forward, this is a company that is also highly sensitive to higher interest rates because it doesn't have deposits; it has to resort to wholesale financing so it gets charged higher interest rates. It's a business that we expect to have a slower performance this year compared to the past year, especially while we still remain on the high interest rate scenario.

Alejandra Naughton:

Hi Fredric. I will speak on the topic regarding our year guidance and net interest margins. As you mentioned, the current situation regarding the interest rate has triggered elevation regarding the pricing of our products. So, let me firstly highlight that the increase in the monetary policy rate that now is settled by 40% was not fully translated on the Badlar rate. That is the rate that we use at the bank for pricing our products. Firstly, I think that's very important to bear in mind because it's a completely different pattern.

Having said that, having observed the increase in the Badlar rate, of course under our assets & liabilities managed we repriced our products on the liability side of the balance sheet and of course on the asset side on the balance sheet, and on the asset side of the balance sheet we consider not only the loan book but also the investment accounts. As a result of this repricing, we expect to have higher spreads and that higher spreads makes us think that our net interest margin will be achieved, will be in the range thinking more on reaching on the higher end of the range. It will depend on how long it will take to observe a slow decline of interest rates, but the first sense on the figures allows us to come up with the conclusion that we will be achieving our guidance close to the upper end of the range.

I would like also to mention that this answer considered the impact for the rest of the year, not necessarily the current quarter or even the next quarter. I think that this is very important because the repricing is different on the liability side than on the asset side of our balance sheet, so you could be seeing in the coming quarter an interest kind of impact on market because our liabilities will be repricing faster than our assets, and even though they have short tenures, they will take a little bit longer than liabilities.

So, all in all, full year the impact expected on NIMs are positive despite high—imagine some kind of different pattern in this quarter, second quarter.

Operator:

Thank you. At this time I will turn the floor back to Ana 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, we remain available to answer any questions that you may have. Thank you and enjoy the rest of your day.

Operator:

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