Argentine Banks

2H16 outlook: what are the signs of the normalization?

Equities

Americas

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Latest data suggest weakness at banks

The debate on Argentine banks is whether loan growth will pick up fast enough to offset declining margins. We currently expect loan growth of 28% p.a. for the next five years, which would bring banking penetration back to pre-2001 levels. Despite the anticipated rising volumes, EPS growth should remain low at 14% for 2017 (vs inflation of ~20%), as margins decline. Trading supports 2016 top line, but operating trends are not showing clear signs of a pick-up yet. While we like the long term story, we reiterate caution from our Initiation on Argentine banks and wait for better entry points.

While growth picks up, asset quality and efficiency remain mostly on track

Loan growth accelerated in recent months to 38%, but remains in negative territory in real terms, as the macro normalization takes longer. Asset quality surprised with a rise in the cost of risk to 2.1% (1.5% in 1Q16). That said, the overall levels of NPL and coverage remain healthy and we expect normalized provisions in 2H16 (back to historical avge). Moreover, while core revenues increase with higher loan growth, we expect opex to grow in line with inflation. We do not expect the banks to capture benefits from operating leverage, as Argentina has low financial inclusion indictors and banks will need to invest in branches.

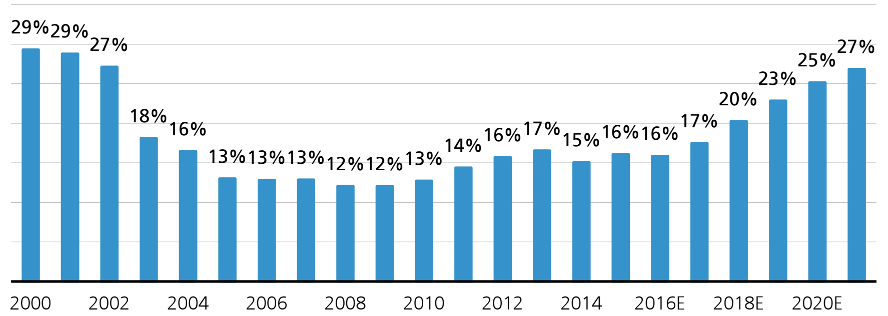
2016-17E EPS growth negative in real terms; 2018E shows real growth

We fully revise our models post-2Q, and expect loan growth for 2016/17 of 34%/31%, with stable NPL, lower securities income and NIMs of 10.6% in 2016 and 9.7% in 2017. On the positive side, fee growth should accelerate (26%/24% in 2016/17E). Overall we expect EPS growth of 24%/14% in 2016/17. Incorporating UBS' FX forecasts of 15.9/18.5 for the ARS, we expect EPADR growth of -23%/-1% in 2016/17.

Valuation: cautious on the banks, prefer GGAL (residual income)

We increase our 2016/17 EPS estimates by +1/7%. We raise our PT to $100 for BMA ($77 before), $40 for GGAL ($36), and maintain $22 for BFR, due to higher securities income (esp. BMA), higher loan growth, FX update. YTD the ADRs have risen by 19% vs 75% for the MSCI LatAm Banks. Argentine banks trade on 11x 2016E EPADR and 3x book, for average ROEs of 29% in 2017E. **Key risks to the upside:** stronger growth, NIM stability, stronger FX, re-inclusion in the MSCI in 2017.

Figure 1: Loan growth is negative in real terms, real growth starts in 2018E



Source: UBS, BCRA latest data as of April 2016

Argentine Banks

UBS Research THESIS MAP	MOST FAVORED	LEAST FAVORED
	Grupo Galicia, Banco Macro	**BBVA Frances**

PIVOTAL QUESTIONS

Q: Can we expect loan growth of 28% in the coming 5 years?

Yes, we assume that loan penetration reverts to pre-crisis levels (pre-2001). The debate on Argentine banks is to understand whether loan growth will pick up fast enough to offset lower declining margins (from abnormally high levels). Pre-2001 levels in terms of banking penetration were 29% for loans/GDP in 2000, vs 16% today (51% for Brazil). Banks need to grow 28% p.a. in the coming five years, from a low base. more →

Q: Should we be concerned about asset quality?

No, although the rise in provisions was a negative surprise in 2Q16. While the weak macro (inflation peak, unemployment rise) could explain some of the higher cost of risk, markets were surprised to see a rise in provisions so early in the cycle. We expect them to normalize in 2H16. Argentine banks report healthy asset quality indicators overall, and they can absorb some modest deterioration. more →

Q: Can operating leverage boost earnings?

No, banks will need to invest in their networks and opex should grow in line with inflation. We believe Argentine banks will need to grow the currently small branch network in the country. Branch presence will be a deciding factor in future M&A. While new technologies and Fintech could help at the margin (only BBVA BFR mentioned this theme), the banking sector starts from a low base, after underinvesting for the past decade. more →

WHAT'S PRICED IN?

Current valuations price in a strong rebound in lending and lower cost of equity. During 2015, Argentine ADRs outperformed (+47% vs. -24% for MSCI EM Banks) on the biggest decrease in cost of equity assumptions among EM banks. Markets currently price in a COE for Argentine banks of 11% (second-best in LatAm after Mexico), down from 20% at the beginning of 2015, and ROE of 28%. Year-to-date, Argentine banks have underperformed, gaining 19% (MSCI LatAm Banks +75%). Arg banks trade on 11x 2016E EPADR and 3x book. Consensus expects EPS growth of 23/17% in 2016/17.

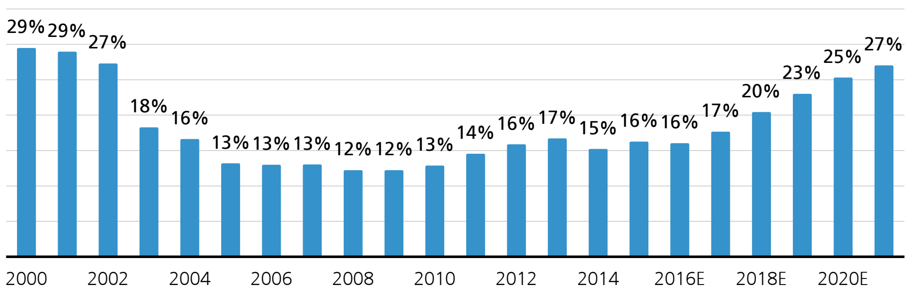
UBS VIEW

2016-17 will be transition years. Macro normalization is good in the long term but means banks need to adapt their business models: Banking intermediation will rise but we caution that it will come at the cost of lower margins. In 2016-17, real gains (above inflation) will probably be limited.

EVIDENCE

Margins are among the highest in the world due to inflationary distortions: Galicia is better positioned due to its network in the provinces and reliance on fees. Macro has a large network and focus on the underserved SME finance segment but depends heavily on securities income. Frances has lost lending market share and has a large reliance on securities income.

Loan growth is now negative in real terms, real growth accelerates after 2018E



Source: UBS, BCRA latest data as of April 2016

Q: Can we expect loan growth of 28% in the coming 5 years?

UBS VIEW

Yes, we assume that loan penetration reverts to pre-crisis levels (pre-2001). The debate on Argentine banks is to understand whether loan growth will pick up fast enough to offset lower declining margins (from abnormally high levels). We believe the Argentine banking system could go back to pre-crisis (pre-2001) levels in terms of banking penetration (loans/GDP of 29% in 2000, vs 16% today). If this were to happen, banks would need to grow 28% p.a. in the coming five years. The base remains low, and we are not saying that loans/GDP will reach the level of other LatAm countries, such as Brazil (51%) or Chile (90%).

EVIDENCE

Loan growth for the three private banks accelerated to 38.4% in June 2016, versus 37.7% in 1Q16. Inflation continues to be elevated at 47%, as per the index observed in Buenos Aires. While loan growth should continue to remain negative in real terms (below inflation in nominal terms), we believe those two curves will invert in 2017. We expect significant gains in loan penetration in real terms only after 2018.

Our cautiously optimistic view on the loan growth is based on the view that the consumer should remain weak in the short term (real wage compression due to the fight on inflation and unemployment), while investment from companies will be slow as capacity utilization remains low at 72%, and interest rates remains too elevated for long term investments.

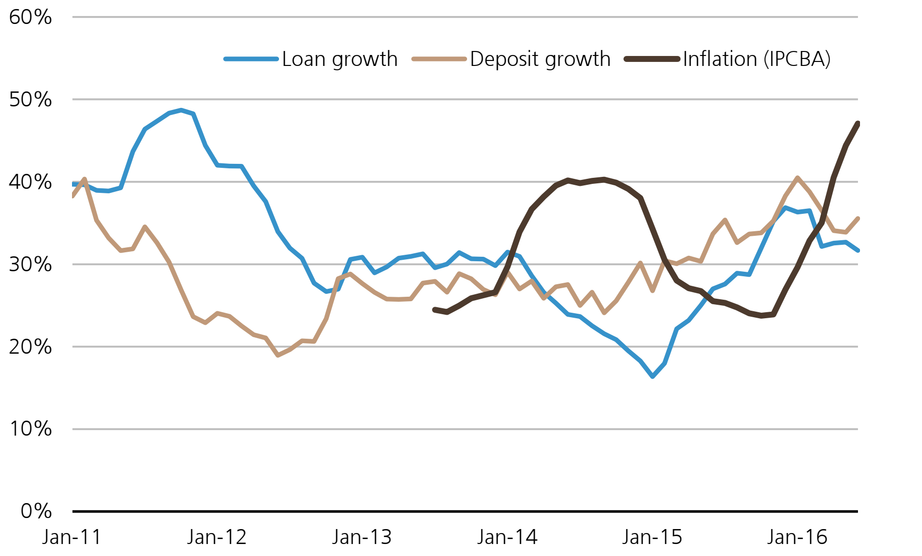
Why not expect more growth? Taking a longer timeframe, we note that loan penetration has been consistently low in Argentina, which is why we find it more realistic to use 2000 as an ambitious but realistic target. We also forecast the three private banks reach a loans-to-deposits ratio of 100% in 2021.

WHAT'S PRICED IN?

Consensus (excluding UBS) is expecting earnings growth of 23% in 2016 and 17% in 2017 in local terms. We looked at the estimates of six analysts in local currency, to remove the discrepancy in FX assumptions.

Considering consensus and current valuations at 3x book value, markets are pricing in fast loan growth, and a slower normalization in margins, which we think is overly optimistic.

Figure 2: Loan growth is negative in real terms



Source: UBS, BCRA latest data as of April 2016

In our previous note following 1Q16 results: How are the Argentine banks coping with the macro-economic normalization, we noted that the macro scenario remained challenging. The observation remains valid today. With high policy rates (28.75%) and inflation (47.2%), and rising unemployment (9.3%), the transition to a normalized economy bears challenges (see Rafael de la Fuente: Argentina: when the going gets tougher). Recent conversations with local banks suggest that the consumer should be weak in the medium term, and corporate investing could take some time to pick up.

Despite a low banking intermediation (loans/GDP at 16%), it could be one to two years before the banking sector grows in real terms. In the meantime, margins should compress from abnormally high levels, as flagged in our Initiation on Argentine banks.

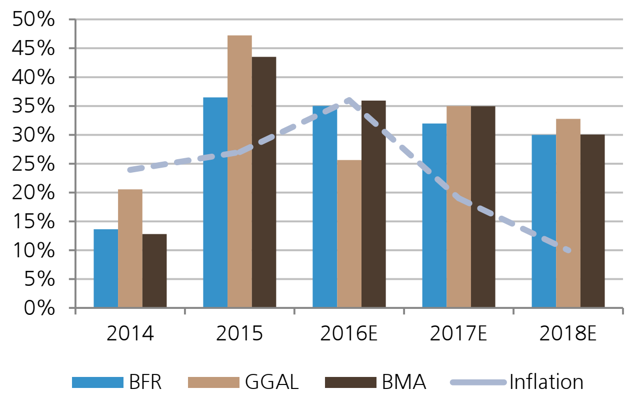
We watch for two triggers to become more constructive. We initiated on Argentine banks with a cautious view and a relative preference for Galicia. Year-to-date, ADRs are up 19%, vs 75% for the MSCI LatAm Banks in USD terms.

We remain constructive on the long term potential of Argentina and watch two main triggers: 1) an improvement in the economy, with a decrease in inflation and better GDP (UBSe: -1.9%/2.5% in 2016/2017) leading to real loan growth. 2) Potential flow events, such as the MSCI EM re-inclusion or the potential sale from Anses pension funds of local holdings. Another trigger could be banking consolidation, with the potential sale of the retail operations (only) of Citibank Argentina (~70 branches). Local banks with a large capital base (eg: BMA) are best positioned for inorganic growth (~Ps5bn asset purchase would lead to a 1.4% Tier I reduction at BMA).

We indicate below our estimates in terms of loan growth. When analysing market shares, we find that Banco Frances has decreased from 7.3% to 6.6% between 1Q08 and 2Q16. In the same time period, Banco Macro decreased, from 8.0% to

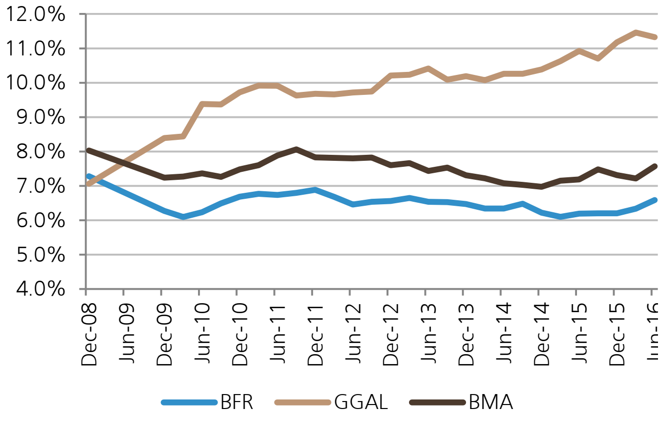
7.6%. Grupo Galicia, in turn, increased its loan market share, from 7.1% to 11.3%.[1]

Figure 3: Loan growth estimates



Source: Company data and UBS estimates

Figure 4: Loan market share



Source: Company data and BCRA

Reverting to the normalized banking penetration level (defined as the level reached pre-2001) would imply that banks grow their loan book by 28% p.a. for the coming five years. Under this growth assumption, the banking penetration would jump from 16% today to 27% by 2021.

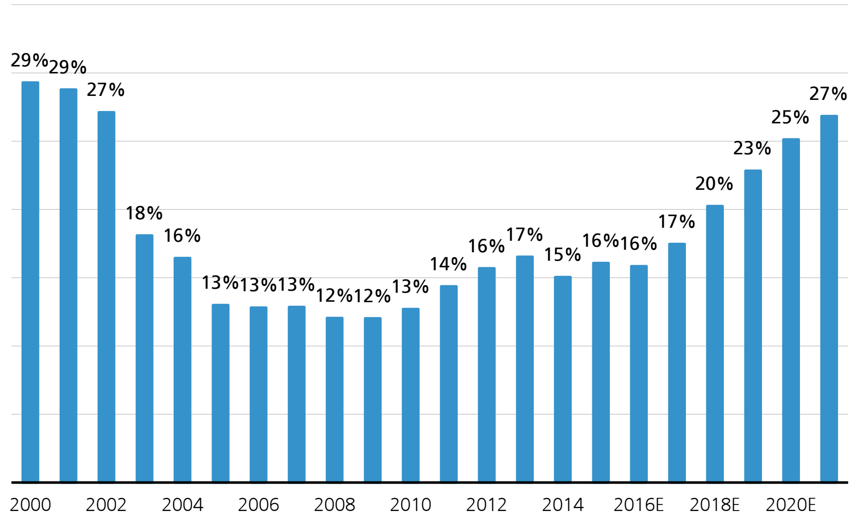
Figure 5: Loans/GDP calculation

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016E	2017E	2018E	2019E	2020E	2021E
GDP (ARS bn)	284	269	313	376	448	647	809	1,027	1,284	1,412	1,811	2,312	2,766	3,406	4,426	5,671	7,605	9,240	10,441	11,276	12,178	13,153
Total system loans (ARS bn)	83	77	85	68	74	84	104	132	155	170	230	332	434	563	666	912	1,206	1,615	2,115	2,575	3,062	3,531
GDP real growth, yoy%	(0.8)	(4.4)	(10.9)	8.8	9.0	9.2	8.4	8.0	3.1	0.1	9.5%	8.4%	0.8%	2.9%	0.5%	1.1%	-1.9%	2.5%	3.0%	3.0%	3.0%	3.0%
Loans nominal growth, yoy%		-7%	10%	-20%	8%	14%	23%	27%	17%	10%	35%	44%	31%	30%	18%	37%	32%	34%	31%	22%	19%	15%
Inflation, yoy%	-1%	-2%	41%	4%	6%	12%	10%	8%	7%	8%	11%	10%	11%	11%	24%	27%	36%	19%	10%	5%	5%	5%
Loans/GDP	29%	29%	27%	18%	16%	13%	13%	13%	12%	12%	13%	14%	16%	17%	15%	16%	16%	17%	20%	23%	25%	27%

Source: BCRA and UBS estimates

[1] BCRA data do not consolidate all non-bank financial subsidiaries and therefore understates the Market share of Banco Macro.

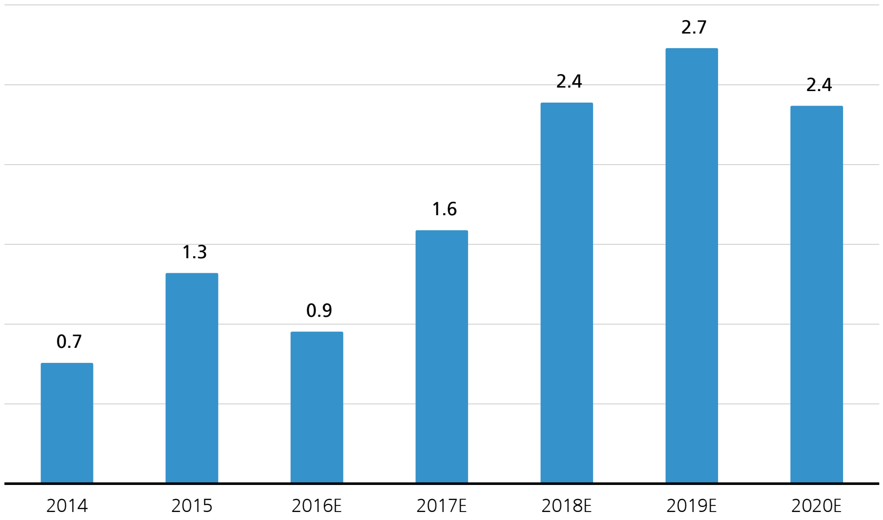
Figure 6: Loans/GDP: Banking penetration reverting to pre-crisis level



Source: BCRA and UBS estimates

Our assumption for loan growth implies a multiplier of 2x on average in the coming two years, which we find ambitious but realistic. This follows two years with a multiplier close to 1x (limited gains in banking penetration).

Figure 7: Loan multiplier (loan growth / nominal GDP growth)



Source: BCRA, UBS

We also assume that banks increase their loans-to-deposits ratios to 100% by 2021, versus 80% on average today.

return ↑

Q: Should we be concerned about asset quality?

UBS VIEW

No, although the rise in provisions was a surprise in 2Q16. The key take away from 2Q16 results was the deterioration in asset quality, in the form of higher provisions for the three banks. While the weak macro (inflation peak, unemployment rise) could explain some of the higher cost of risk, markets were surprised to see a rise in provision so early in the cycle. We do not see the rising provisions as a trend, and expect them to normalize in 2H16. Cost of risk in 2Q, although higher on a sequential basis, remained in the average of the past years. Argentine banks report healthy asset quality indicators overall, and they can absorb some modest deterioration.

EVIDENCE

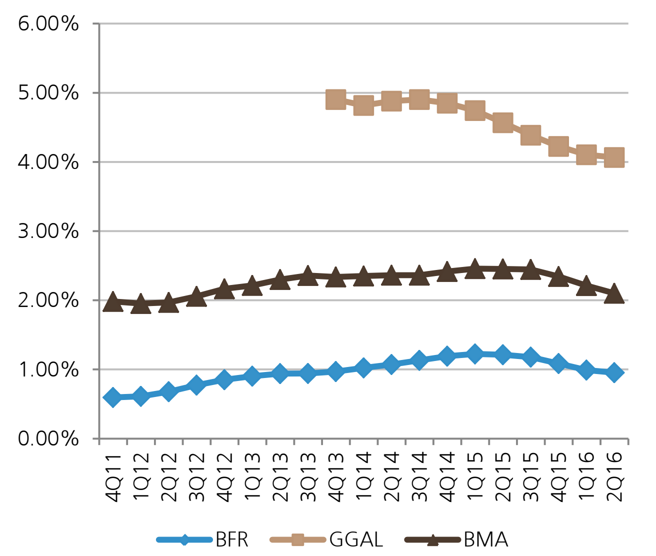
The ratio of NPL formation increased across the board. The ratio of NPL formation to total loans (new NPLs + write offs / loans) increased to 3.5% in 2Q16 from 2.7% in 1Q16 for the three banks, compared to 3.3% on average in 2015. The cost of risk (provisions/loans) also increased for the three banks by 57ps on average to 2.1% from 1.5%.

However, the NPL ratio of the three banks was relatively stable on a sequential basis, and coverage ratios continue to be high by EM standards, at 1.9%/166%.

WHAT'S PRICED IN?

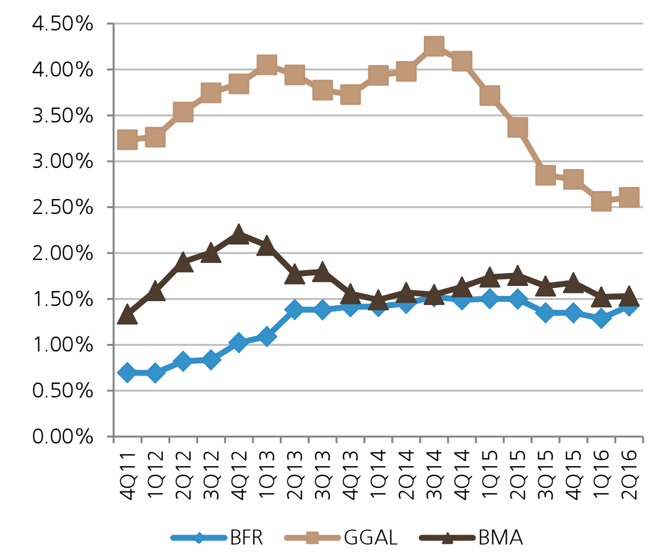
Markets were surprised with the asset quality deterioration in the form of higher provisions, and this is atypical for countries so early in the credit cycle. This begs the question of the ability of the banks to grow strongly, without giving revenues back in the form of higher provisions.

Figure 8: Ratio of NPL formation (NPLs + Charge-off/average loans)



Source: Company data

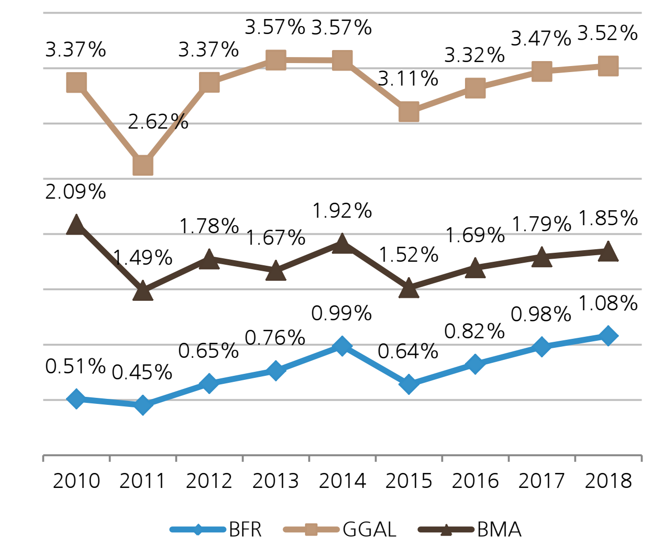
Figure 9: Cost of risk (provisions/loans)



Source: Company data

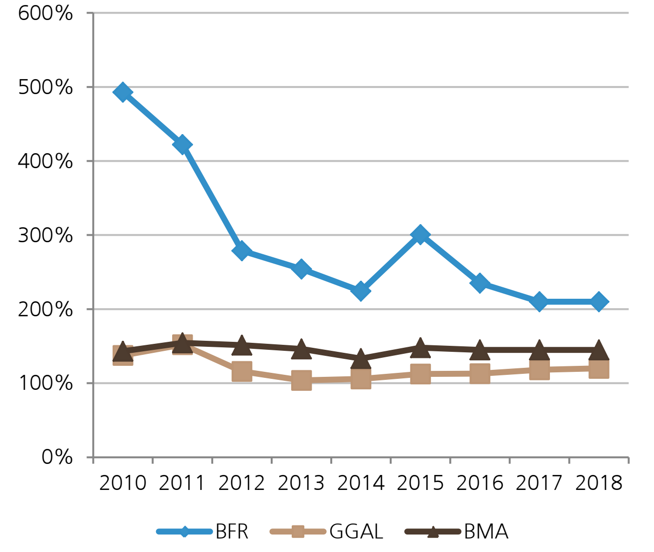
As shown above, some key asset quality indicators deteriorated in 2Q16. We note however that the NPL and coverage ratios (presented below) continue to be very healthy by EM standards.

Figure 10: NPL ratio



Source: Company data and UBS estimates; '16-18 are UBS estimates

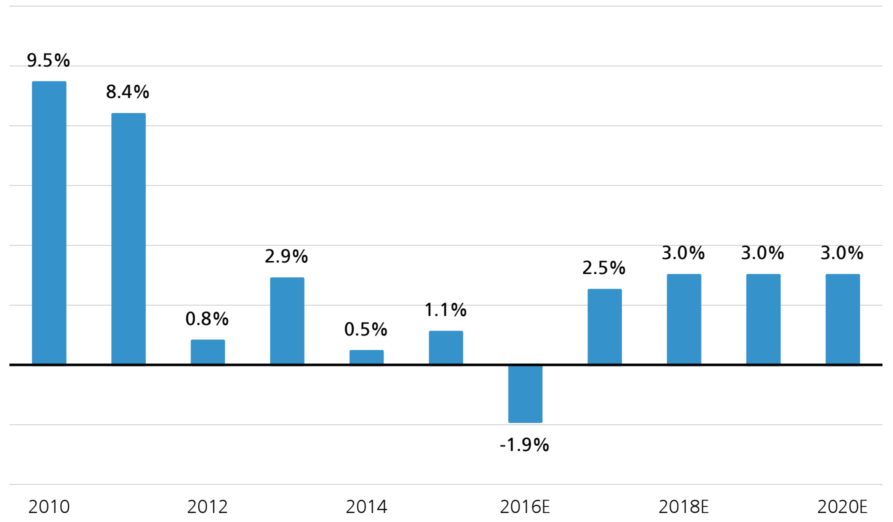
Figure 11: Coverage ratios (Loan loss reserves/NPL)



Source: Company data and UBS estimates; '16-18 are UBS estimates

As we expect the GDP to trough in 2016 and then rebound in 2016, we believe those asset quality indicators should not weigh on profitability overall.

Figure 12: GDP real growth



Source: BCRA and UBS estimates

PIVOTAL QUESTIONS

return ↑

Q: Can operating leverage boost earnings?

UBS VIEW

No, banks will need to invest in their networks and opex should grow in line with inflation. As loan growth picks up, will the extra revenues flow directly to the bottom line or will banks need to invest in their branch network and employees? We believe Argentine banks will need to grow the currently small branch network in the country. Moreover, branch presence will be a deciding factor in future M&A. While new technologies and fintech could help at the margin, the banking sector starts from a low base, after underinvesting for the past decade, and will require brick-and-mortar. Fintech remains marginal for now, with just Banco Frances mentioning it as a core focus, benefiting from the know-how and products developed at the BBVA headquarters in Spain.

EVIDENCE

We used traditional Central Bank data and crossed them with unique financial inclusion indicators from the World Bank to gauge the level of banking penetration (Findex data).

The number of branches per 100k inhabitants remains among the lowest in Latin America at 13, versus 47 for Brazil. Moreover, the number of branches in the Argentine system has grown at just 2% per annum over the past decade, suggesting banks have not invested enough in their networks.

Finally the current level of operating efficiency remains in the average of Latin American average, suggesting there is no clear idle capacity, or opportunity to cut costs.

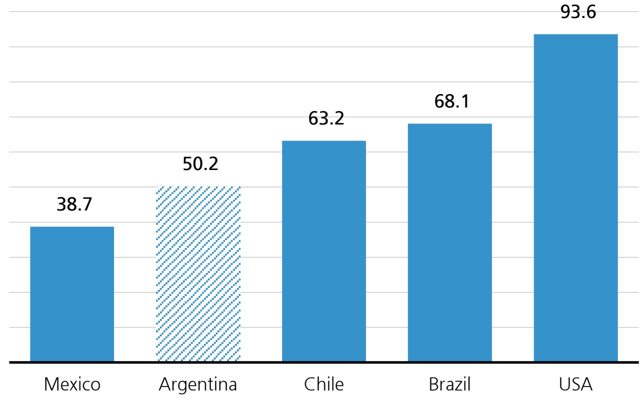
WHAT'S PRICED IN?

We believe that markets are assigning a significant probability for operating leverage, and expect the rise in revenues to flow directly to the bottom line and support a rise in profitability. We also believe that markets are not following the currently low datasets on financial inclusion.

Findex data is a unique and extremely rich set of primary data compiled by the World Bank. It combined macro data (such as number of branches by country) as well as individuals' use of their local banking network, based on surveys and interviews with thousands of customers globally. The last update of the Global Financial Inclusion Database happened in 2015.

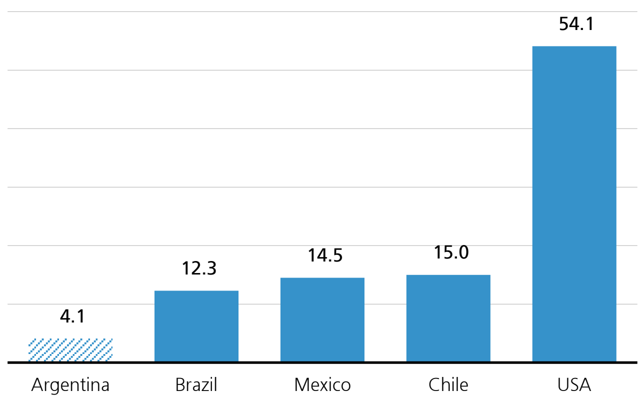
Data suggest a very low banking intermediation in Argentina. For example, only 50% of adults report having a bank account (94% in the US), while just 4% save with a financial institution (54% in the US) and 8% have borrowed from a bank (23% in the US). Moreover, the number of branches per 100k inhabitants remains among the lowest in Latin America at 13, versus 47 for Brazil.

Figure 13: Individuals with an account at a financial institution (% age 15+)



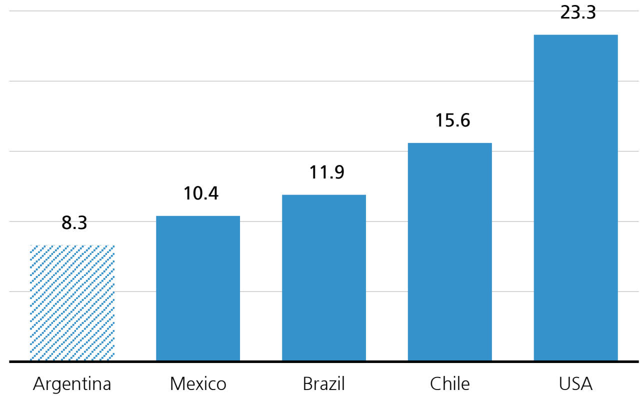
Source: UBS and Findex World Bank

Figure 14: Individuals who saved at a financial institution (% age 15+)



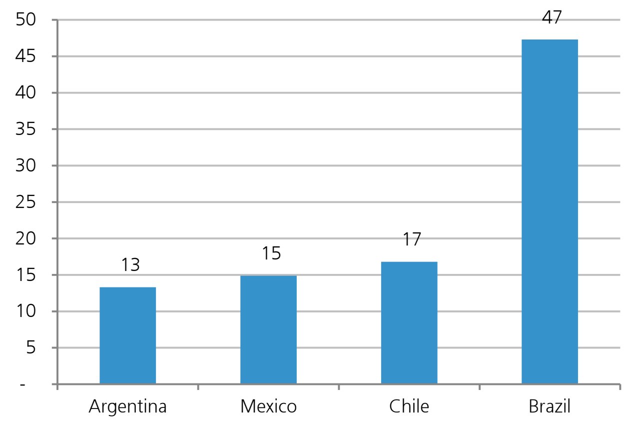
Source: UBS and Findex World Bank

Figure 15: Individuals who borrowed from a financial institution (% age 15+)



Source: UBS and Findex World Bank

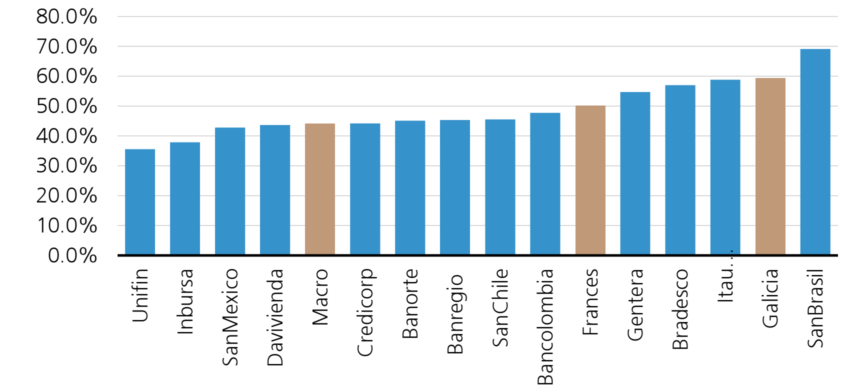
Figure 16: Number of commercial bank branches per 100,000 adults (2015)



Source: UBS and Findex World Bank

That said, the level of efficiency is in the average for LatAm banks, suggesting Argentine banks do not have meaningful cost synergies to capture when growth picks up. In fact, the cost-to-income ratio for the three Argentine banks reached 51% in 2Q16, vs 48% for Latin American banks, on average.

Figure 17: Cost-to-income ratio for LatAm banks



Source: Company data

Valuation, EPS and PT changes

We derive our price target and ratings from a residual income valuations. We also use a Gordon growth and comparables' analyses (P/E multiples) to support our view on the stock.

Our cost of equity for Argentine banks is 11.5% for Banco Frances (unchanged), 12.0% for Banco Macro (vs. 12.25% before, on the back of a stronger earnings track record), and 12.0% for Grupo Galicia (vs 12.25% previously, on the back of a stronger earnings track record). We believe Banco Frances deserves a slight discount in cost of equity versus its peers due to its good capital position and better asset quality. We use a market risk premium of 5% for all financials under our coverage and a risk free rate of 7% for all Argentine banks.

Following 2Q results, conversations with the three banks, and using the latest macro and system data, we fully revised our models.

As detailed in the table below, we increase our EPS for 2016-17E for the three banks. The main reason for the EPS revision comes from:

1) stronger than expected securities income in 2H16 following strong 2Q trading – which we view as low quality – especially for Banco Macro;

2) higher loan growth projection after 2018, following a more bullish view of the local banks in the medium term;

3) higher fee income following the regulatory relaxation in consumer fees to be implemented in September 2016;

4) an adjustment in FX forecasts, following UBS macro update by Rafael de la Fuente. We now expect a FX at 15.9 at the end of 2016 and 18.5 at the end of 2017.

Figure 18: EPS changes to 2016-2017 estimates

	EPS 2016E			EPS 2017E		
	New	Old	Change (%)	New	Old	Change (%)
BFR	8.5	8.3	3%	9.6	8.4	13%
GGAL	4.2	4.4	-5%	5.0	4.8	4%
BMA	10.7	10.1	6%	11.9	11.5	4%

Source: UBS. We compare our estimates before the Argentine banks reported 2Q16 results with our current estimate.

Figure 19: EPADR changes to 2016-2017 estimates

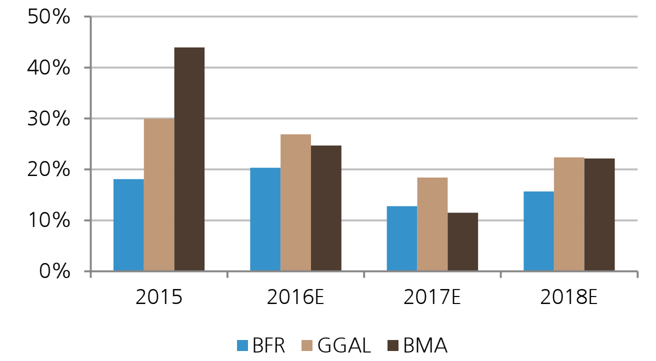
	EPADR 2016E			EPADR 2017E		
	New	Old	Change (%)	New	Old	Change (%)
BFR	1.7	1.7	4%	1.7	1.4	17%
GGAL	2.9	3.0	-4%	2.9	2.7	7%
BMA	7.3	6.8	7%	7.0	6.5	7%

Source: UBS. We compare our estimates before the Argentine banks reported 2Q16 results with our current estimate.

Our new estimates imply EPS growth of 24.0% on average for 2016 for the three banks, and 14.2% in 2017.

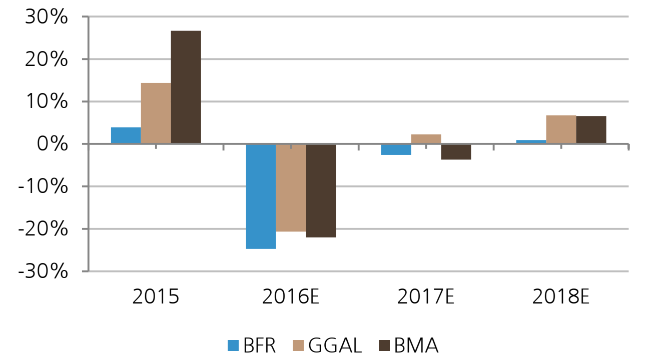
If we look at ADRs, we are forecasting earnings per ADR growth of -23% in 2016 and -1% in 2017. We note that our EPADR forecasts are sensitive to FX forecast changes from UBS economist. Rafael de la Fuente currently expects the ARS/USD to reach 15.9 by 2016-end and 18.5 by 2017-end.

Figure 20: EPS growth 2016-2017E



Source: Company data and UBS estimates

Figure 21: EPADR growth 2016-2017E



Source: Company data and UBS estimates

Price target revisions

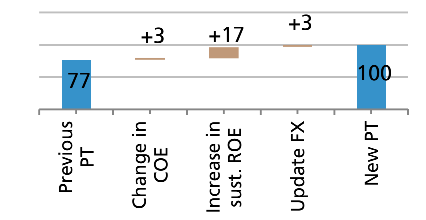
We adjust our price target for the three ADRs.

For **Banco Macro**, we increase our price target from US$77 to US$100, mostly to reflect 1) a higher securities income (explaining the ROE posted in 2Q16 of 40%), 2) higher than previously expected margins, and 3) higher loan growth in the long term (both organic and via M&A) due to its high capital position, translating into a higher sustainable ROE of 31% (up from our previous estimate of 22%). For Banco Macro, our price target for the ADR is now based on a FX of ARS/USD of 18.5 (versus 19 before), which further helps the price target.

For **Grupo Galicia**, we increase our price target from US$36 to US$40, mostly on 1) higher securities earnings following 2Q results, and 2) higher loan growth in the long term, translating into a higher sustainable ROE of 28% (up from our previous estimate of 23%). For Galicia, our price target for the ADR is now based on a FX of 18.5 (versus 19 before), which further helps the price target.

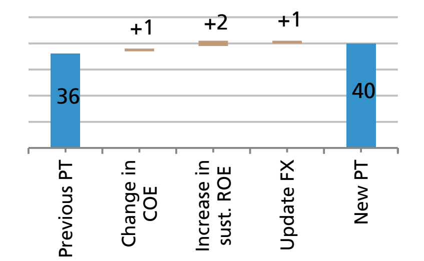
For **Banco Frances**, we maintain our price target at US$22. While we also increase the sustainable ROE for BFR to 26% (up from our previous estimate of 21%) mostly due to higher loan growth in the long term, we also roll our price target for the ADR to 2017E from end-2016E. Our PT is based on a FX of 18.5, while our previous PT used the more favourable FX for 2016.

Figure 22: BMA: price target revision



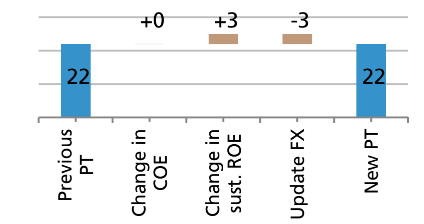
Source: UBS estimate

Figure 23: GGAL: price target revision



Source: UBS estimate

Figure 24: BFR: price target revision



Source: UBS estimate

We indicate below the P/E and P/BV multiples for the universe of LatAm financials.

Figure 25: LatAm Banks Comps table

BANKS	Ticker	Rating	Price (local)	Target price (local)	Target upside (%)	Mkt Cap (US$ mn)	EPS		P/E		P/BV		Adj. ROE (%)		Dividend Yield
							2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E	12m forward (%)
Banco do Brasil	BBAS3.SA	Sell (CBE)	22.9	16.0	-30.1	20,094	3.0	3.7	7.8	6.2	0.8	0.7	10.3	11.7	3.6
Bradesco	BBDC4.SA	Neutral	28.6	30.2	5.4	48,708	3.0	3.3	9.5	8.8	1.6	1.4	17.5	16.8	5.2
Itaú Unibanco	ITUB4.SA	Buy	35.7	39.5	10.6	66,568	3.4	3.8	10.4	9.4	1.9	1.6	18.8	18.6	4.0
Santander Brasil	SANB11.SA	Sell	22.6	17.5	-22.4	26,114	1.5	1.8	14.8	12.8	1.5	1.4	10.2	11.4	6.3
BTG Pactual[1]	BBTG11.SA	Not Rated	17.0	n.a.	n.a.	4,582	4.5	4.2	4.0	4.2	0.7	n.a	n.a	n.a	-
Banrisul[1]	BRSR6.SA	Not Rated	10.4	n.a.	n.a.	1,302	1.5	1.7	7.1	6.5	0.7	0.7	10.4	11.1	-
Brazilian Banks						**167,369**	**3.0**	**3.3**	**10.3**	**9.2**	**1.5**	**1.4**	**15.5**	**15.5**	**4.5**
Gentera	GENTERA.MX	Neutral	35.1	38.0	8.2	3,111	2.4	2.7	14.7	13.1	3.5	2.9	24.1	22.0	0.0
Banorte	GFNORTEO.MX	Buy	103.0	117.8	14.3	15,361	7.0	8.2	14.7	12.5	1.9	1.7	13.7	14.5	1.5
Inbursa	GFINBURO.MX	Buy	32.3	47.0	45.4	11,584	2.1	2.5	15.2	12.9	1.8	1.7	12.7	13.6	2.2
Santander Mexico	SANMEXB.MX	Buy	35.6	35.6	0.1	12,955	2.3	2.5	15.7	14.4	1.9	1.8	12.8	13.0	2.9
Banregio	GFREGIOO.MX	Buy	105.3	125.0	18.7	1,857	6.7	7.4	15.7	14.3	2.8	2.5	18.9	18.6	1.9
Unifin	UNIFINA.MX	Buy	53.0	63.0	18.9	1,005	3.4	4.0	15.7	13.1	3.8	3.2	25.4	26.4	1.6
Mexican Banks						**45,873**	**4.0**	**4.6**	**15.2**	**13.3**	**2.1**	**1.9**	**14.4**	**14.8**	**2.0**
Frances	BFR.N	Sell	20.2	22.0	8.9	3,617	1.7	1.7	11.7	12.0	3.3	2.7	30.8	28.4	1.7
Galicia	GGAL.O	Neutral	30.2	40.0	32.5	2,900	2.9	2.9	10.5	10.3	2.9	2.3	32.1	29.2	0.0
Macro	BMA.N	Neutral (UR)	79.0	100.0	26.6	4,618	7.3	7.0	10.9	11.3	3.1	2.6	33.1	28.8	0.3
Bancolombia	CIB.N	Sell	39.4	30.0	-23.9	9,481	3.4	3.5	11.6	11.1	1.4	1.3	12.9	13.0	2.7
Davivienda	DVI_p.CN	Buy	28,740	34,000	18.3	4,400	3,561	3,953	8.1	7.3	1.3	1.2	17.0	16.8	4.2
Credicorp	BAP.N	Buy	157.0	170.8	8.8	12,522	12.5	14.6	12.6	10.8	2.1	1.9	19.0	20.1	4.6
Banco de Chile[1]	CHI.SN	Not Rated	74.9	n.a.	n.a.	10,947	5.6	6.0	13.3	12.3	2.7	2.4	19.6	19.8	4.7
Santander Chile	BSAC.K	Neutral	21.4	19.9	-7.1	10,096	1.6	1.8	13.8	12.0	2.3	2.1	18.2	19.5	4.3
Andean Banks						**58,582**			**12.1**	**11.2**	**2.3**	**2.0**	**20.3**	**20.2**	**3.5**
Europe					2.5	984,617			9.7	8.6	0.7	0.7	8.0		5.6
EMEA					9.1	274,715			8.1	7.0	0.9	0.9	13.3		4.5
Asia (ex-Japan)					-2.5	1,565,812			7.3	6.7	0.9	0.8	13.0		4.2
Latin America					6.6	250,875			9.7	8.6	1.7	1.5	17.3		3.7
Developed					5.6	2,491,773			10.2	9.1	0.8	0.8	8.9		4.3
GEM					0.1	2,091,403			7.6	7.0	1.0	0.9	13.7		4.2
Global Average						**2,015,252**			**7.5**	**6.9**	**1.0**	**0.9**	**13.9**		**4.2**

Source: Bloomberg and UBS estimates. Note price is as of Aug 28th. Consensus data used for Not Rated companies.

Grupo Financiero Galicia SA

2H16 cautious outlook and potential market share losses

Equities

Americas
Banks, Ex-S&L

12-month rating	**Neutral**
12m price target	**US$40.00**
	Prior: US$36.00
Price	**US$30.82**

RIC: GGAL.O **BBG:** GGAL US

Trading data and key metrics

52-wk range	US$32.16-17.15
Market cap.	US$2.96bn
Shares o/s	96.0m (COM)
Free float	94%
Avg. daily volume ('000)	293
Avg. daily value (m)	US$8.8
Common s/h equity (12/16E)	AP19.8bn
P/BV (12/16E)	3.0x
Tier 1 ratio	14%

EPS (UBS, diluted) (US$)

	From	To	% ch	Cons.
12/16E	2.91	2.88	-1	-
12/17E	2.70	2.94	9	-
12/18E	2.74	3.14	15	-

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Latest data suggest weakness at banks

The debate on Argentine banks is whether loan growth will pick up fast enough to offset declining margins. We currently expect loan growth of 28% p.a. for the next five years, which would bring banking penetration back to pre-2001 levels. Despite the rising volumes, EPS growth should remain low at 14% for 2017 (vs inflation of ~20%), as margins decline. Trading supports 2016 top line, but operating trends are not showing clear signs of a pick-up yet. While we like the long term story, we reiterate caution from our Initiation on Argentine banks and wait for a better entry point.

While growth picks up, asset quality and efficiency remain mostly on track

Loan growth accelerated in recent months to 38%, but remains in negative territory in real terms, as the macro normalization takes longer. Asset quality surprised with a rise in the cost of risk to 2.1% (1.5% in 1Q16). That said, the overall levels of NPL and coverage remain healthy. Moreover, while core revenues increase with higher loan growth, we expect opex to grow in line with inflation. We do not expect the bank to capture benefits from operating leverage, as Argentina has low financial inclusion indictors and banks will need to invest in branches.

2016-17E EPS growth negative in real terms; 2018E shows real growth

We expect loan growth for 2016/17 of 34%/31%, with a slight deterioration in NPL. We expect lower securities income and NIMs of 10.6% in 2016 and 9.7% in 2017. On the positive side, fee growth should accelerate (26%/24% in 2016/17E). Overall we expect EPS growth of 24%/14% in 2016/17. Incorporating UBS' FX forecasts of 15.9/18.5 for the ARS, we expect EPADR growth of -23%/-1% in 2016/17

Valuation: Neutral, PT: $40 (residual income)

We increase our price target to $40 for GGAL ($36) due to higher securities income, higher loan growth, lower FX. Since early June, the ADRs have risen by 13% vs 62% for the MSCI LatAm Banks. Argentine banks trade on 11x 2016E EPADR and 3x book, for average ROEs of 29% in 2017. Key risks to the upside: stronger growth, NIM stability, stronger FX, re-inclusion in the MSCI in 2017.

Highlights (APm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	12,469	17,192	22,623	29,394	35,727	41,644	48,269	54,772
Profit before tax	3,264	5,560	7,504	8,817	10,317	12,596	15,825	18,791
Net earnings (local GAAP)	1,824	3,338	4,338	5,504	6,517	7,974	10,051	11,955
Net earnings (UBS)	1,824	3,338	4,338	5,504	6,517	7,974	10,051	11,955
Tier 1 ratio %	-	12.7	11.2	13.8	14.2	14.6	16.1	17.7
EPS (UBS, diluted) (US$)	3.49	4.29	4.91	2.88	2.94	3.14	3.59	4.15

Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
ROE (UBS) %	30.9	38.8	35.1	32.1	29.2	28.6	29.0	27.8
P/PPOP (diluted)	0.8	1.3	1.9	5.0	4.6	4.3	3.9	3.5
P/BV x	0.7	1.0	1.8	3.0	2.4	1.9	1.5	1.3
P/BV (UBS) x	0.7	1.0	1.8	3.0	2.4	1.9	1.5	1.3
P/E (UBS, diluted)	2.1	3.0	4.3	10.7	10.5	9.8	8.6	7.4
Net dividend yield %	1.5	0.8	0.5	0.0	3.7	4.9	6.0	7.5

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US$30.82 on 29 Aug 2016 19:40 EDT

UPSIDE / DOWNSIDE SPECTRUM

return ↑

Galicia is trading at 10.5x PE2016E (as of 28 Aug).

Value drivers	Loan growth	NIM	LLP as % of Average Loans	EPADR change from base	Sustainable ROE
$43.0 upside	30.6%	9.0%	2.5%	8.7%	28.75%
$40.0 target	25.6%	8.8%	2.7%	-	28.00%
$27.0 downside	20.6%	8.6%	2.9%	-8.5%	27.25%

Our scenarios depend on assumptions in three key lines: loan growth, net interest margin, loan loss provisions.

Upside (US$43.0): Our upside scenario for 2016 assumes loan growth of 30.6%; NIM being increased by 20bps above our current estimate, to 9.0%; and loan loss provisions (as a percentage of average loans) decreasing by 20bps, to 2.5%. We estimate upside risk to 2016E EPADR of 8.7% to US$3.13, while the derived valuation per share would be US$43.0.

Base (US$40.0): Our base scenario for 2016 assumes loan growth of 25.6%; NIM at 8.8%; and loan loss provisions (as a percentage of average loans) at 2.7%. We estimate base to 2016E EPADR at US$2.88, with price target of US$40.0.

Downside (US$27.0): Our downside scenario for 2016 assumes loan growth of 20.6%; NIM being decreased by 20bps below our current estimate, to 8.6%; and loan loss provisions (as a percentage of average loans) increasing by 20bps, to 2.9%. We estimate downside to 2016E EPADR of 8.5% to US$2.63, while with derived valuation per share at US$27.0

Banco Macro SA

2H16: growth appetite hampered by a weak macro economy

Equities

Americas
Banks, Ex-S&L

12-month rating	**Neutral**
12m price target	**US$100.00**
	Prior: US$77.00
Price	**US$79.72**

RIC: BMA.N **BBG:** BMA US

Trading data and key metrics

52-wk range	US$80.73-37.15
Market cap.	US$4.66bn
Shares o/s	58.5m (COM)
Free float	62%
Avg. daily volume ('000)	29
Avg. daily value (m)	US$2.1
Common s/h equity (12/16E)	AP21.8bn
P/BV (12/16E)	3.2x
Tier 1 ratio	22%

EPS (UBS, diluted) (US$)

	From	To	% ch	Cons.
12/16E	7.16	7.26	1	-
12/17E	6.69	7.00	5	-
12/18E	6.60	7.46	13	-

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Latest data suggest weakness at banks

The debate on Argentine banks is whether loan growth will pick up fast enough to offset declining margins. We currently expect loan growth of 28% p.a. for the next five years, which would bring banking penetration back to pre-2001 levels. Despite the rising volumes, EPS growth should remain low at 14% for 2017 (vs inflation of ~20%), as margins decline. Trading supports 2016 top line, but operating trends are not showing clear signs of a pick-up yet. While we like the long term story, we reiterate caution from our Initiation on Argentine banks and wait for a better entry point.

While growth picks up, asset quality and efficiency remain mostly on track

Loan growth accelerated in recent months to 38%, but remains in negative territory in real terms, as the macro normalization takes longer. Asset quality surprised with a rise in the cost of risk to 2.1% (1.5% in 1Q16). That said, the overall levels of NPL and coverage remain healthy. Moreover, while core revenues increase with higher loan growth, we expect opex to grow in line with inflation. We do not expect the bank to capture benefits from operating leverage, as Argentina has low financial inclusion indictors and banks will need to invest in branches

2016-17E EPS growth negative in real terms; 2018E shows real growth

We expect loan growth for 2016/17 of 34%/31%, with a slight deterioration in NPL. We expect lower securities income and NIMs of 10.6% in 2016 and 9.7% in 2017. On the positive side, fee growth should accelerate (26%/24% in 2016/17E). Overall we expect EPS growth of 24%/14% in 2016/17. Incorporating UBS' FX forecasts of 15.9/18.5 for the ARS, we expect EPADR growth of -23%/-1% in 2016/17.

Valuation: Neutral, PT: $100 (residual income)

We increase our price target to $100 for BMA ($77 before), due to higher securities income, higher loan growth, lower FX. Since early June, the ADRs have risen by 13% vs 62% for the MSCI LatAm Banks. Argentine banks trade on 11x 2016E EPADR and 3x book, for average ROEs of 29% in 2017E. Key risks to the upside: stronger growth, NIM stability, stronger FX, re-inclusion in the MSCI in 2017.

Highlights (APm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	8,350	11,629	15,633	21,143	25,080	29,636	34,166	39,744
Profit before tax	3,795	5,465	7,530	9,667	10,614	12,957	15,397	19,170
Net earnings (local GAAP)	2,444	3,480	5,008	6,245	6,963	8,504	10,110	12,595
Net earnings (UBS)	2,444	3,480	5,008	6,245	6,963	8,504	10,110	12,595
Tier 1 ratio %	24.2	23.1	19.9	22.3	21.5	20.9	20.9	21.6
EPS (UBS, diluted) (US$)	7.69	7.37	9.31	7.26	7.00	7.46	8.04	9.72

Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
ROE (UBS) %	33.0	34.6	36.6	33.1	28.8	29.2	29.3	30.5
P/PPOP (diluted)	1.4	2.6	3.2	6.2	6.2	5.8	5.4	4.6
P/BV x	0.8	1.4	2.4	3.2	2.6	2.2	1.8	1.5
P/BV (UBS) x	0.8	1.4	2.4	3.2	2.6	2.2	1.8	1.5
P/E (UBS, diluted)	2.5	4.5	5.4	11.0	11.4	10.7	9.9	8.2
Net dividend yield %	0.0	0.4	0.4	0.1	0.3	0.4	0.4	0.5

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US$79.72 on 29 Aug 2016 19:40 EDT

UPSIDE / DOWNSIDE

BMA is trading at 10.9x PE16e (as of 28 Aug).

Value drivers	Loan growth	NIM	LLP as % of Average Loans	EPADR change from base	Sustainable ROE
$105 upside	43.9%	13.4%	1.8%	14.5%	33.0%
$100 target	35.9%	12.6%	1.9%	-	31.0%
$75 downside	31.9%	12.4%	2.0%	-4.9%	31.0%

Source: UBS

Our scenarios depend on assumptions in three key lines: loan growth, net interest margin, loan loss provisions

Upside (US$105.0): Our upside scenario for 2016 assumes loan growth of 43.9%; NIM being increased by 80bps above our base case estimate, to 13.4%; and loan loss provisions (as a percentage of average loans) decreasing by 10bps, to 1.8%. We estimate upside risk to 2016E EPADR of 14.5% to US$8.32, while the derived valuation per share would be US$105.

Base (US$100.0): Our base scenario for 2016 assumes loan growth of 35.9%; NIM at 12.6%; and loan loss provisions (as a percentage of average loans) at 1.9%. We estimate base to 2016E EPADR at US$7.26, with price target of US$100.

Downside (US$75.0): Our downside scenario for 2016 assumes loan growth of 31.9%; NIM being decreased by 20bps below our base case estimate, to 12.4%; and loan loss provisions (as a percentage of average loans) increasing by 10bps, to 2.0%. We estimate downside risk to 2016E EPADR of 4.9% to US$6.91, while the derived valuation per share would be US$75.

BBVA Banco Frances SA

2H16 outlook: are there signs that BFR is closing the profitability gap?

Equities

Americas
Banks, Ex-S&L

12-month rating	Sell
12m price target	US$22.00
Price	US$20.57

RIC: BFR.N **BBG:** BFR US

Trading data and key metrics

52-wk range	US$24.77-15.02
Market cap.	US$3.68bn
Shares o/s	179m (COM)
Free float	24%
Avg. daily volume ('000)	26
Avg. daily value (m)	US$0.5
Common s/h equity (12/16E)	AP16.2bn
P/BV (12/16E)	3.4x
Tier 1 ratio	15%

EPS (UBS, diluted) (US$)

	From	To	% ch	Cons.
12/16E	1.71	1.73	1	-
12/17E	1.53	1.69	11	-
12/18E	1.44	1.70	18	-

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Loan growth accelerated in recent months to 38%, but remains in negative territory in real terms, as the macro normalization takes longer. Asset quality surprised with a rise in the cost of risk to 2.1% (1.5% in 1Q16). That said, the overall levels of NPL and coverage remain healthy. Moreover, while core revenues increase with higher loan growth, we expect opex to grow in line with inflation. We do not expect the bank to capture benefits from operating leverage, as Argentina has low financial inclusion indictors and banks will need to invest in branches.

2016-17E EPS growth negative in real terms; 2018E shows real growth

We expect loan growth for 2016/17 of 34%/31%, with a slight deterioration in NPL. We expect lower securities income and NIMs of 10.6% in 2016 and 9.7% in 2017. On the positive side, fee growth should accelerate (26%/24% in 2016/17E). Overall we expect EPS growth of 24%/14% in 2016/17. Incorporating UBS' FX forecasts of 15.9/18.5 for the ARS, we expect EPADR growth of -23%/-1% in 2016/17.

Valuation: Sell, PT: $22 (residual income)

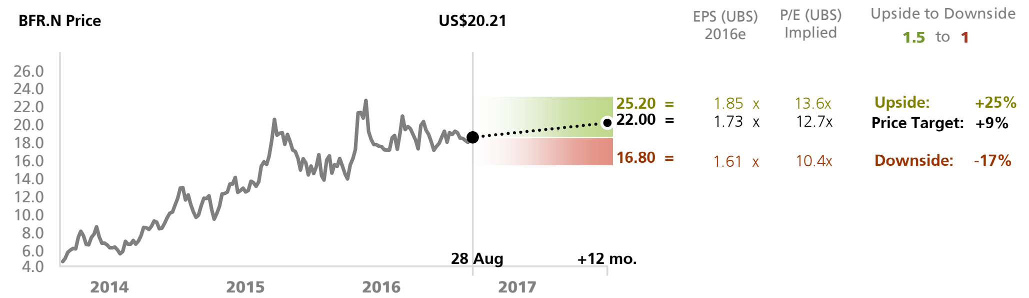
We maintain our price target at $22, despite higher earnings (mostly on higher loan growth) due to a less favourable FX (rolling to 2017E with FX of 18.5). Since early June, the ADRs have risen by 13% vs 62% for the MSCI LatAm Banks. Argentine banks trade on 11x 2016E EPADR and 3x book, for average ROEs of 29% in 2017E. Key risks to the upside: stronger growth, NIM stability, stronger FX, re-inclusion in the MSCI in 2017.

Highlights (APm)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	7,573	11,150	13,313	17,337	20,385	23,187	26,557	30,435
Profit before tax	3,200	4,981	5,965	7,442	8,275	9,299	10,744	12,620
Net earnings (local GAAP)	2,024	3,204	3,784	4,554	5,135	5,940	6,869	8,077
Net earnings (UBS)	2,024	3,204	3,784	4,554	5,135	5,940	6,869	8,077
Tier 1 ratio %	18.2	15.4	14.6	15.0	15.3	14.7	14.8	14.9
EPS (UBS, diluted) (US$)	2.08	2.21	2.30	1.73	1.69	1.70	1.78	2.04
Profitability/valuation	**12/13**	**12/14**	**12/15**	**12/16E**	**12/17E**	**12/18E**	**12/19E**	**12/20E**
ROE (UBS) %	33.7	37.6	32.3	30.8	28.4	27.4	27.2	29.3
P/PPOP (diluted)	1.4	2.7	4.5	6.5	6.6	6.6	6.2	5.4
P/BV x	0.9	1.6	9.3	3.4	2.8	2.4	2.0	1.7
P/BV (UBS) x	0.9	1.6	9.3	3.4	2.8	2.4	2.0	1.7
P/E (UBS, diluted)	2.6	4.7	7.8	11.9	12.2	12.1	11.5	10.1
Net dividend yield %	0.0	0.2	0.0	1.7	2.0	3.6	3.8	4.2

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of US$20.57 on 29 Aug 2016 19:40 EDT

UPSIDE / DOWNSIDE SPECTRUM

return ↑



Frances is trading at 11.7x PE16E (as of 28 Aug).

Value drivers	Loan growth	NIM	LLP as % of Average Loans	EPADR change from base	Sustainable ROE
$25.2 upside	40%	10.6%	1.0%	7.1%	26.75%
$22.0 target	35%	10.4%	1.2%	-	26.00%
$16.8 downside	30%	10.2%	1.4%	-7.0%	25.25%

Our scenarios depend on assumptions in three key lines: loan growth, net interest margin, loan loss provisions.

Upside (US$25.2): Our upside scenario for 2016 assumes loan growth of 40%; NIM being increased by 20bps above our current estimate, to 10.6%; and loan loss provisions (as a percentage of average loans) decreasing by 20bps, to 1.0%. We estimate upside risk to 2016E EPADR of 7.1% to US$1.85, while the derived valuation per share would be US$25.2.

Base (US$22.0): Our base scenario for 2016 assumes loan growth of 35%; NIM at 10.4%; and loan loss provisions (as a percentage of average loans) at 1.2%. We estimate base to 2016E EPADR at US$1.73, with price target of US$22.0.

Downside (US$16.8): Our downside scenario for 2016 assumes loan growth of 30%; NIM being decreased by 20bps below our current estimate, to 10.2%; and loan loss provisions (as a percentage of average loans) increasing by 20bps, to 1.4%. We estimate downside to 2016E EPADR of 7.0% to US$1.61, while the derived valuation per share at US$16.8.

Banco Macro SA Investment case

2016-17 will be transition years. Macro normalization is good in the long term but means banks need to adapt their business models. Banking intermediation will rise but we caution that it will come at the cost of lower margins. In 2016-17, real gains (above inflation) will probably be limited.

BBVA Banco Frances SA Investment case

2016-17 will be transition years. The economic normalization is good in the long term but means banks need to adapt their business models. Banking intermediation will rise but we caution that it will come at the cost of lower margins. In 2016-17, real gains (above inflation) will probably be limited.

Grupo Financiero Galicia SA Investment case

2016-17 will be transition years. Macroeconomic normalization is good in the long term but means that Galicia needs to adapt its business models. Banking intermediation will rise but we caution that it will come at the cost of lower margins. In 2016-17, real gains (above inflation) will probably be limited.

Valuation Method and Risk Statement

For Banco Macro, our PT is derived from a residual income, with a CoE of 12.0%, a sustainable ROE of 31% and growth of 6%.
For Banco Frances, our PT is derived from a residual income, with a CoE of 11.5%, a sustainable ROE of 26% and growth of 6%.
For Grupo Galicia, our PT is derived from a residual income, with a CoE of 12.0%, a sustainable ROE of 28% and growth of 6%.

LatAm financials' performance is closed linked to the local economic conditions and changes in interest rate and foreign exchange. Also, Latin American financials may be affected by changes in regulatory framework and the overall local competition and foreign competition. These factors impact all companies mentioned in this note.
We value Argentine banks based on a residual income model, using forecasted earnings to which we deduct a cost of equity. We define a sustainable return on equity and sustainable earnings growth. Our cost of equity is based on the long term risk free rate, to which we add a market risk premium multiplied by the stock's beta.

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12-Month Rating	Definition	Coverage[1]	IB Services[2]
Buy	FSR is > 6% above the MRA.	47%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	25%
Sell	FSR is > 6% below the MRA.	15%	21%
Short-Term Rating	**Definition**	**Coverage[3]**	**IB Services[4]**
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 30 June 2016.
1:Percentage of companies under coverage globally within the 12-month rating category.
2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.
3:Percentage of companies under coverage globally within the Short-Term rating category.
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UBS Brasil CCTVM S.A.: Frederic De Mariz; Mariana Taddeo. **UBS Limited:** Philip Finch.

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Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
Banco Macro SA[16]	BMA.N	Neutral (UR)	N/A	US$79.72	29 Aug 2016
BBVA Banco Frances SA[5, 16]	BFR.N	Sell	N/A	US$20.57	29 Aug 2016
Grupo Financiero Galicia SA[5, 16]	GGAL.O	Neutral	N/A	US$30.82	29 Aug 2016

Source: UBS. All prices as of local market close.
Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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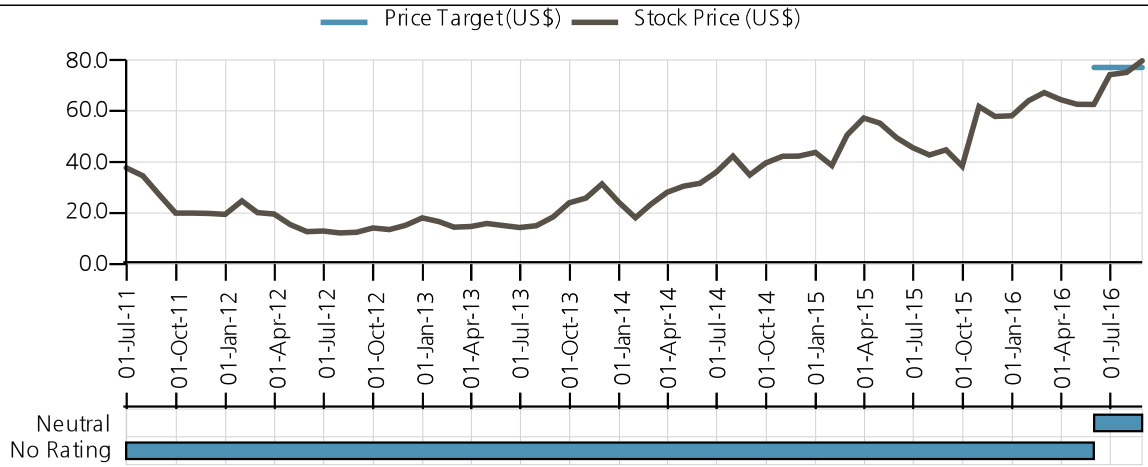
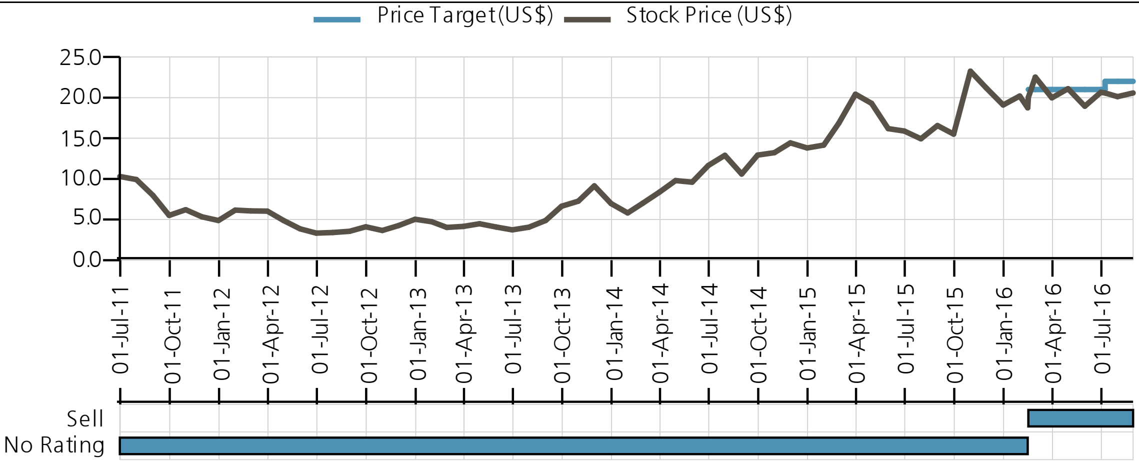
Banco Macro SA (US$)



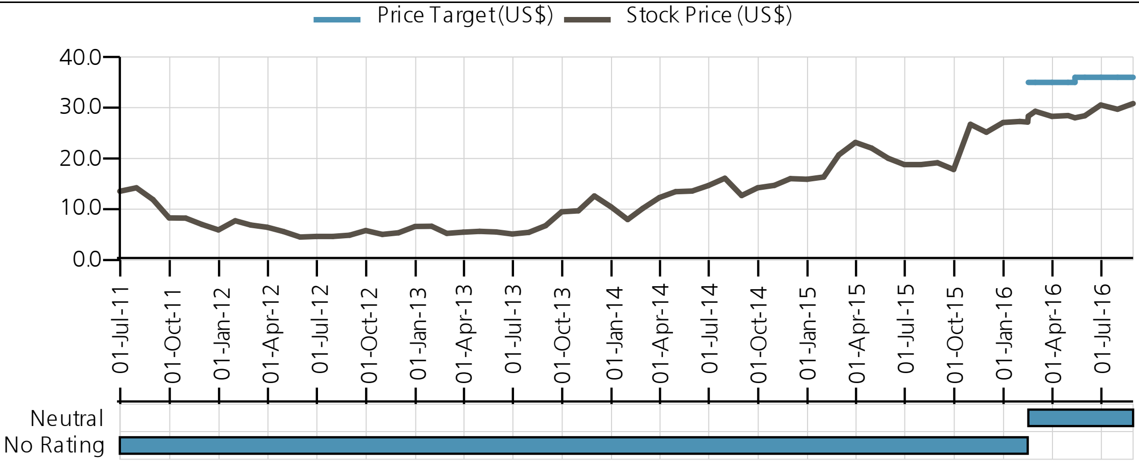
Source: UBS; as of 29 Aug 2016

BBVA Banco Frances SA (US$)



Source: UBS; as of 29 Aug 2016

Grupo Financiero Galicia SA (US$)



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