FINAL TRANSCRIPT

Street Capital Group Inc.

First Quarter Results

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CORPORATE PARTICIPANTS

Jonathan Ross
Street Capital Group – Head of Investor Relations

Ed Gettings
Street Capital Group – Chief Executive Officer

Marissa Lauder
Street Capital Group – Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Marc Charbin
Laurentian Bank Securities – Analyst

PRESENTATION

Operator

Hi, everyone. Welcome to Street Capital Group's First Quarter 2017 Financial Results Conference Call. As a reminder, this call is being recorded on Wednesday, May 10, 2017. At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question and answer session. Instructions will be provided at that time for research analysts to queue up for questions. If anyone has any difficulties hearing the conference, please press star, zero for Operator assistance at any time.

I will now turn the call over to Jonathan Ross, Head of Investor Relations for Street Capital Group. Please go ahead, Mr. Ross.

Jonathan Ross – Head of Investor Relations, Street Capital Group Inc.

Thanks, Jessa. Good morning, everyone, and thanks for joining us today. I'm joined on the call today by Ed Gettings, Chief Executive Officer of Street Capital, and Marissa Lauder, Chief Financial Officer.

Street Capital Group's First Quarter 2017 financial results were released today. The press release, financial statements and MD&A are available on SEDAR, as well as our website at streetcapitalgroup.ca.

Before passing the call over to Management, we would like to remind listeners that portions of today's discussion contain forward-looking statements that are based on Management's exercise of business judgment, as well as assumptions made by, and information currently available to, Management. When used in this conference call, the words "may," "plan," "will," "anticipate," "believe," "estimate," "expect," "intend," and words of similar import, are intended to identify any forward-looking statements. You should not place undue reliance on these forward-looking statements. These statements reflect our current view of future events and are subject to certain risks and uncertainties, as outlined in the Company's Annual Information Form and other filings made with securities regulators, which are available on SEDAR, www.sedar.com.

Factors include, without limitation, expansion opportunities, technological changes, regulatory changes and requirements, including mortgage insurance rules, changes to the business and economic environment, including, but not limited to, Canadian housing market conditions and activity, interest rates, mortgage backed securities markets, and employment conditions, that may impact the Company, its mortgage origination volumes, launch of new products at planned times, investments, and capital expenditures, and competitive factors that may impact revenue and operating costs.

Any of these factors, amongst other, could cause actual results to differ materially from the current results or from the Company's currently anticipated future results and financial condition. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, our actual results could differ materially from those anticipated in these forward-looking statements.

We undertake no obligation, and do not intend, to update, revise or otherwise publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof, or to reflect the occurrence of any unanticipated events. Although we believe that our expectations are based on reasonable assumptions, we can give no assurance that our expectations will materialize.

I will now the pass the call over to Ed Gettings, Chief Executive Officer.

Ed Gettings – Chief Executive Officer, Street Capital Group Inc.

Thanks, Jon. Good morning, everyone, and thank you for participating on today's call.

Despite the headwinds in Q1 2017, I was pleased with the new mortgage origination volumes in Q1, which are $1.22 billion, just above the $1.19 billion from last year. However, gain on sale rates were lower and adjusted EPS came in flat, compared to $0.02 last year. Marissa will discuss further financial details after my comments.

Our goal is to maintain a strong number four share position in the broker channel during 2017. The market share report for Q1 2017 was not available at the time of our earnings release. However, we are happy to update you when it is out later this week.

At Street Capital, we always conduct our business with prudence and conservativism. Since the Bank was founded 10 years ago, we segregate the sales and underwriting functions. In our view, this is, and always will be, the most basic requirement to ensure the quality of our underwriting decisions and their financial execution.

Furthermore, our underwriting practices adhere to all principles set forth in OSFI's B-20 guidelines, and as such, we validate income and down payments, along with collateral values, through multiple methods. This ensures strong demand for our mortgages and sets the foundation for a strong balance sheet with underlying strong customer profiles. The result is that our serious arrears rates continue to outperform the industry. In Q1, our serious arrears rate was 12 basis points, compared to the average of the large Canadian banks in the market where we operate at 26 basis points.

While we operate within a risk-based framework, meaning that we focus more diligently on the areas of higher risk, we currently conduct quality assurance on 100 percent of the loan applications coming from a new broker relationship and roughly 50 percent of the loans from our trusted mortgage broker partners, and when we launch our new uninsured mortgage product line, 100 percent of the applications will have a full property appraisal and 100 percent will go through the quality assurance review.

Furthermore, we execute quality assurance on a pre-funding basis. Quality assurance, in effect, represents a second set of eyes on a loan, and with the diligence we apply, it is considered similar to re-underwriting the mortgage. In our experience, this is far above what any of our peers do, be they big banks or other lenders in the market. It costs us far more to do this, but it helps to ensure credit quality and strong demand for our mortgages, and a solid base of quality customers.

Over the past several weeks, some Canadian mortgage lenders have faced concerns regarding the viability of their funding models. While this concern began with a single mortgage lender, the questions are being posed by every company in the sector, including Street Capital. I would like to assure you right now that the issues faced by our mortgage lending peers are not representative of the risks we face today at Street Capital. We are a prudent and quality lender in the prime mortgage space and we will carry the same discipline as we expand into the uninsured space later this quarter. Our focus on credit quality, along with a stable and conservative funding approach, ensures that we are well positioned to capitalize on the opportunities generated by market turbulence.

Our Bank has not been affected by the recent funding and liquidity challenges experienced by some of the other regulated FIs in recent weeks. Today, all of our originated prime loans are insurable and are sold at the commitment stage to our various liquidity providers. This funding model for insurable mortgages is a deliberate and important strategy for Street Capital, as it contributes to the mitigation of both funding and interest rate risk. With recent market disruption, we have not experienced any reductions in the availability of funding or demand from our funders for prime insured mortgage products.

We expect to begin lending in the uninsured segment of the market later this month. While the uninsured mortgages will reside on our balance sheet, rather than being sold to investors, we have purposely structured our funding and liquidity in a conservative manner. We are funding these loans with fixed-term GICs that will be duration matched with the underlying mortgage loans. We currently are not offering demand deposit products, such as high interest savings accounts. We are managing our liquidity position conservatively, to ensure that we will not face a liquidity crisis, like that faced by our mortgage lending peer over the past few weeks.

We have a robust corporate governance framework in place. We have a majority independent active Board, with collective decades of significant industry-specific experience, both operating and managing large Canadian FIs. Our Management Team is highly experienced and includes leaders that have run large mortgage and consumer credit portfolios and financial operations at other Canadian financial institutions.

As a financial institution, trust and confidence are our most important assets, and we do not take that lightly. Our Management Team and Board of Directors work diligently every day to retain and build the trust and confidence of our shareholders, institutional funders, mortgage brokers, regulators, depositors and customers. Through good times and challenging ones, we have built a reputation for honest, factual communication.

Over the past two years, we have steadily increased our disclosure, to ensure that shareholders and other key stakeholders have a full understanding of where we stand. This is how we built this business and it is how we will build Street Capital Bank. Between Management and the Board of Directors, we own just about 25 percent of this Company. We are aligned to build this Company the right way for the long term.

However, providing a detailed outlook in the current environment is challenging, for a number of reasons. The impact on our business, given the changes to mortgage insurance rules announced by the Department of Finance in October 2016, along with the recent release of the Ontario government's Fair Housing Plan, are still uncertain. These changes, combined with potentially elevated housing market conditions in certain locations, and the recent events in the mortgage lending industry, make it increasingly difficult to estimate mortgage lending activity, mortgage rates and spreads, and in the interest of full transparency, right now there are certain portions of our business where the uncertainty is too great for us to provide guidance this quarter. We believe we have good visibility into the volumes of prime insured mortgages that we can generate. However, the market is in flux on the prime uninsured side of our business, making gain on sale rates, and thus EPS, more difficult to predict in the near term.

I'd like to walk you through some commentary regarding our outlook before handing the call over to Marissa.

The foundation of our business is the prime insured segment. These are high-ratio transactionally insured mortgages and conventional mortgages that qualify for portfolio insurance. From a top line perspective, we have access to considerable liquidity and demand for these loans, and can fund all of our requirements. Market forces, including the recent changes to mortgage insurance rules, increase the competition for prime insured mortgages. This has led to some spread compression that lasted longer than we normally expect and into Q1 2017. We saw some normalization in the latter part of Q1, and we do expect the spreads to normalize as the market adjusts to these new rules.

We expect to maintain our strength in the renewal of prime insured mortgages and we will begin to see significant year-over-year growth beginning in Q2, as projected. Renewals can be, roughly, two times more profitable than new originations and will be a significant contributor to our earnings profile over the next few years, and will continue contributing to our strategy as we move forward. Our almost $28 billion of mortgages under administration provide both a sustainable portfolio of quality revenue-generating assets and a customer base that will drive significant value over the coming years, as the Bank expands into additional product areas.

As a result of the recent mortgage rule changes, there was a growing segment of prime mortgages that no longer qualify for mortgage insurance. We refer to these as prime uninsured mortgages. Through one of our liquidity providers, we had access to funding for these loans. However, we have approached the tail end of that current allotment. We had believed that our allotment would be increased and that other funders would become available, but market conditions have evolved, such that progress has slowed down on this front. We are actively pursuing additional funding for this specific product, and with our industry-leading credit quality, are in a strong position to attract it.

We are also actively investigating the market for non-government-sponsored residential mortgage backed securities, or RMBS, and we are evaluating this opportunity. However, given the uncertainty of the timing of funding availability for prime uninsured mortgages, we are taking a more conservative view of new prime origination volumes in 2017, and expect that, in total, new originations could be down between 20 and 30 percent from 2016.

We are on plan to launch our uninsured mortgage product this month and still anticipate originating between $150 million to $200 million this year. We have begun taking GICs and are pleased with the flow of funds and the term structure for the deposits.

Events in recent weeks are likely to present us with several growth opportunities in the coming year. Our Management Team and Board will carefully evaluate these opportunities within our framework of prudent lending and growth. We have never sought to grow quickly at the expense of reputation or credit quality, or by taking undue liquidity risk, and this holds true in the current context.

We have begun our search for a President to replace Lazaro DaRocha. We have made good progress and I look forward to updating you in the coming months.

While all industry participants are facing challenges this year, we believe that we are well positioned. We have strong relationships with our valued broker partners, a solid balance sheet, and a diversified funding base which will continue to underpin the growth and shareholder returns over the long term. Our prudent approach to risk management and quality underwriting will underpin our focus on fulfilling our vision for a consumer-centric financial institution.

Now, I will turn the call over to Marissa for some additional commentary.

Marissa Lauder – Chief Financial Officer, Street Capital Group Inc.

Thanks, Ed, and good morning, everyone. As Ed mentioned in his commentary, adjusted diluted earnings per share in Q1 were flat, compared to $0.02 last year. Adjusted net income was actually slightly positive at $69,000, or $94,000 before tax. Overall, I would say solid origination volumes and renewal volumes were offset by lower gain on sale rates, while we held the line on expenses.

We originated $1.22 billion of mortgages, slightly above last year, and we renewed $304.6 million in Q1. The renewal rates were well within our target range of 75 to 80 percent. While renewals were lower than the $328 million we renewed in Q1 2016, this is due to the maturity profile of the mortgages coming up for renewal. We continue to expect renewal volumes to increase meaningfully over 2016 in Q2 to Q4.

Gross gain on sale rates were 177 basis points, up 11 basis points from Q4 and flat to last year. As Ed mentioned, there was some spread compression from Q4 that lingered into Q1. We have observed some improvement in March and Q2, and expect spread improvement in Q2 for prime insurable mortgages and renewals.

Acquisition expense rates, at 107 basis points, are in line with our expectations, given the relative volume of renewals in the quarter and the term mix of new originations. New originations have been trending towards a higher mix of five-year fixed, which attracts the highest commission rates.

Expenses were managed carefully in the quarter, declining 8 percent from last quarter. This decline really reflects the downward adjustment to variable pay that reflects our quarterly results. Also, included in Q1, is the one-time charge of $3.6 million for Mr. DaRocha's retiring allowance. This $3.6 million is excluded from our non-GAAP measure of adjusted net income and adjusted EPS.

At Street Capital, we are focused on credit quality as our number one priority. As in the past, our credit quality continues to be strong. As Ed mentioned, at March 31, the serious arrears rate on our portfolio of mortgages was 12 basis points, well below the CBA performance. This is also below last year, which at 13 basis was also a very good rate on a well-seasoned portfolio.

As at the end of March, at the time of originations, the weighted average beacon score of our portfolio was 747, the weighted average loan to value ratio was 80.7 percent, and the average total debt service ratio was 36.3 percent.

Now, for a look forward. As discussed by Ed, we have updated our business outlook this quarter. We remain confident in our target to originate between $150 million and $200 million of quality uninsured mortgages by the end of 2017. We are on target to launch this product later this month. We are also confident in our targets for 2019, as previously set out. We also expect to generate net interest margin of 2 to 2.5 percent on these loans. We may see some increases in funding costs, but we believe that this will be offset by increases in mortgage pricing for this product. We continue to expect renewal volumes of $1.8 billion to $1.9 billion this year, with increases over 2016, focused in the Q2 to Q4 period. Our expected ranges for renewal volumes in 2018 and 2019 also remain on target.

As Ed also discussed, the level of prime mortgage originations and the margins earned is difficult to predict at this time. We are still seeing very strong demand for prime insurable mortgages, and we did have funding for prime uninsurable mortgages in Q1.

Moving into Q2, we are beginning to observe some declines in commitment, as our funding for the prime uninsured product is limited and our prices are higher than the market. Given these facts, it is possible that overall prime mortgage originations could be down 20 to 30 percent from 2016. While we are hopeful that prime uninsured funding will become available over the next few months, the ultimate profitability of this product is still uncertain. However, we believe that the expansion of our product suite across prime insured, prime uninsured and true uninsured will lead to a strong market position and improving mortgage origination volumes over time. We are starting from a strong position to take advantage of market opportunities in the coming months and years.

As mentioned, a key priority this quarter is to launch our uninsured mortgage product, and we expect to do so later this month. We began raising deposits through the deposit dealer network in February, and since the end of the March, we have continued expanding our dealer base and have increased our GIC inflows on a meaningful basis. Based on observations of our deposit flows over the last few weeks, we did not experience a reduction in deposit inflows associated with the issues experienced by certain other regulated financial institutions.

As Ed mentioned, we do not offer demand deposit products and we have less than 5 percent in the 90-day cashable one-year GIC product. Our deposit base on May 4 was $28.4 million. The term mix consists of 36 percent of one-year GICs, 13 percent of two-year GICs, 4 percent of three-year GICs, 4 percent of four-year GICs, and 21 percent of five-year GICs.

Through the market liquidity events over the last few weeks, the Management Team reviewed our funding plans and our liquidity and interest rate risk management practice, under both normal and stressed conditions. Based on the results of our review, we determined that we do not need additional liquidity, either through our current warehouse line or as a backstop liquidity line. We remain confident that our plan to originate $150 million to $200 million in uninsured mortgages this year is achievable within a prudent liquidity tolerance.

We also remain on track to launch credit card operations in 2018.

In closing, I would like to say that Street Capital Bank is standing on solid footing today and we have a credible path forward to drive significant value in the coming years. Thank you.

Now, I would like to open the call for your questions.

Q & A

Operator

At that this time, if you are a research analyst and would like to ask a question, please press star, followed by the number one on your telephone keypad. Again, that's star, followed by the number one on your telephone keypad, and we will pause for just a moment to compile the Q&A roster.

Again, if you would like to ask a question, please press star, followed by the number one on your telephone keypad.

Your first question comes from the line Marc Charbin from Laurentian Bank Securities. Please go ahead.

Marc Charbin – Analyst, Laurentian Bank Securities

Good morning. I'd like to get a sense of your salaries and benefits, and what percent is variable comp.

Marissa Lauder – Chief Financial Officer, Street Capital Group Inc.

Well, I don't want to give any competitive information away, but it's somewhere between 30 and 40.

Marc Charbin – Analyst, Laurentian Bank Securities

Okay. So, with the forecast decline in new originations, that would also impact variable comp, similar to the way it did in Q1, on an adjusted basis.

Marissa Lauder – Chief Financial Officer, Street Capital Group Inc.

Well, bonuses or variable pay would always be a function of our available income to share.

Marc Charbin – Analyst, Laurentian Bank Securities

Okay, I understand. With respect to the prime uninsured, I'm trying to just understand the market dynamic here, and is it the fact that insurance rates have gone up, therefore, portfolio insurance is more expensive, so there's less spread there?

Ed Gettings – Chief Executive Officer, Street Capital Group Inc.

Sorry, Marc, again, which segment are you referring to, prime insured or prime—

Marc Charbin – Analyst, Laurentian Bank Securities

The prime uninsured that you—so, low ratio, that you previously used to securitize. I'm not trying to go towards the on-balance-sheet uninsured that you're developing.

Ed Gettings – Chief Executive Officer, Street Capital Group Inc.

Yes. So, we're describing this new segment as prime uninsured. It's uninsurable because of the Department of Finance rule changes that were announced late last year. So, that would affect refinances, rentals, properties greater than $1 million in terms of purchase price, as well as—those are the segments that are being affected. So, that product is no longer insurable and what we have to do is find another liquidity provider that either is willing to hold it on their balance sheet or find a non-government-sponsored securitization vehicle.

Marissa Lauder – Chief Financial Officer, Capital Street Group Inc.

So, Marc, your question about—so, in the high ratio transactionally insured, prime insured market, there has been some spread compression because there's a significant amount of demand for that product by all lenders. So, from a pricing perspective, to remain competitive, we have had to take slightly lower gains on sale. On the low ratio but still insurable product, which is really what we're calling here now prime uninsurable product, which Ed was talking about, but then there's also the low ratio prime insurable product, which is the stuff that's still insurance, but the portfolio insurance rates have gone up.

Marc Charbin – Analyst, Laurentian Bank Securities

Right. So, your commentary is more about stuff that the Department of Finance won't do anymore, as opposed to increases in portfolio insurance on low LTV mortgages?

Ed Gettings – Chief Executive Officer, Street Capital Group Inc.

Yes, that is correct, from a volume segment. That's the one segment where we had liquidity for that. We're at the tail end of that liquidity. We're diligently looking for additional liquidity for the prime uninsurable space.

Marc Charbin – Analyst, Laurentian Bank Securities

Okay, and right now wouldn't meet the criteria for you to keep it on your on-balance-sheet funded by deposits?

Marissa Lauder – Chief Financial Officer, Street Capital Group Inc.

Well, I mean, we could. It's just that the return wouldn't satisfy the capital requirements.

Marc Charbin – Analyst, Laurentian Bank Securities

Oh, so it's still a lower spread product?

Marissa Lauder – Chief Financial Officer, Street Capital Group Inc.

Yes, it would be very low spread at this time.

Marc Charbin – Analyst, Laurentian Bank Securities

All right, understood. That's it for me. Thank you.

Ed Gettings – Chief Executive Officer, Street Capital Group Inc.

Thanks, Marc.

Operator

Again, if you would like to ask a question, please press star, followed by the number one on your telephone keypad.

There are no further questions at this time. Mr. Ross, I turn the call back over to you.

Jonathan Ross – Head of Investor Relations, Street Capital Group Inc.

Thanks, everyone, for participating on the call today and for your ongoing support. If you have any other questions, feel free to reach out throughout the day. Thanks and have a good one.

Operator

This concludes today's conference call. You may now disconnect.