IFS 1Q17 Conference Call
May 11, 2017 @ 10:00 AM ET

Operator: Good morning and welcome to the Intercorp Financial Services first quarter 2017 conference call. All lines have been placed on mute to prevent any background noise. After the presentation, we will open the floor for questions. At this time, instructions will be given as to the procedure to follow if you would like to ask a question.

It is now my pleasure to turn the time over to Rafael Borja of i-advize Corporate Communications. Sir, please begin.

Rafael Borja: Thank you and good morning everyone. On today's call, Intercorp Financial Services, will discuss its first quarter 2017 earnings. We are very pleased to have with us Mr. Luis Felipe Castellanos, Chief Executive Officer of Intercorp Financial Services, Ms. Michela Cassasa, Chief Financial Officer of Intercorp Financial Services, Mr. Juan Pablo Segura, Chief Financial Officer of Interseguro and Mr. Reyanldo Roisenvit, Chief Executive Officer of Inteligo Group.

They will be discussing the results that were distributed yesterday. There is also a presentation to accompany these results. If you didn't receive a copy of the presentation or the earnings, it is now available on the company's website, ifs.com.pe to download a copy. Otherwise, for any reason if you need any assistance today, please call i-advize in New York at 212-406-3693.

I would like to remind you that today's call is for investors and analysts only, therefore questions from the media will not be taken. It is now my pleasure to turn the call over to Mr. Luis Felipe Catellanos, Intercorp's Chief Executive Officer for his opening remarks. Mr. Castellanos, please go ahead.

L. Felipe Castellanos: Thank you. Good morning and thanks to all for joining our earnings quarter to review our first quarter 2017 results. This year has proved to be a more challenging year than expected. GDP growth expectations for the year stand now at around 3 percent, as internal consumption continues to be weak coupled by the delay in the recovery of private and public investment. El Nino Costero came up as a big surprise and many regions in the country were affected and declared in emergency, especially in the north and the central regions with a full impact still to be assessed.

On the positive side, we have to say that expectations for 2018 are better. Since the country should go into recovery mode into investments aligned with the reconstruction of the affected areas, full effect of the government's actions targeted to boost up the economy and better expectations from the business community.

The financial system continues with low growth and low activity with a PDL ratio system wide increasing to one of the highest levels during the last years. Nevertheless, the financial system in Peru remains solid, profitable and well-capitalized.

Under that scenario, Interbank was able to grow its loan portfolio in the first quarter mainly as a result of the recovery of our commercial portfolio. However, the activity in our retail business contracted, mainly in consumer financing given the low growth witnessed in internal consumption and the risk tightening measures we have taken since mid-year 2016 to manage the deterioration of the quality of the portfolio and with the aim to migrate to better risk-quality customer segments.

We continue to see strong increase in provisions, particularly due to the deterioration of our credit cards portfolio. Our focus continues to be centered in managing risk and maintaining good efficiency levels while we continue to heavily invest in our digital efforts. The impact for El Nino is still to be assessed. We will go into some detail later on the call.

Interseguro continues to manage the aftermath of the changes in regulation with management focused in efficiency and launching new products to diversify into new segments. With AUM north of 5.6 billion, Interseguro continues to be a leading company in the life insurance industry. It is worth to mention that we expect no direct impact from El Nino in our insurance operations.

Inteligo had a very solid quarter achieving strong growth. Inteligo continues to provide IFS with a good level of earnings diversification with strong fee income and with very profitable and efficient operations. Now let me pass it on to Michela to continue with our report.

Michela Casassa: Thank you Luis Felipe. Let me add some additional comments related to the Peruvian economy and financial system. There has been a downward revision of the 2017 GDP growth from around 4.5 percent to 3.5 percent and consequent upward revision of the 2018 figures. The downward revision is due mainly to three reasons.

First, the recent Nino phenomenon, which according to certain consultancy firms, has impacted GDP growth by roughly one percent mainly in sectors such as agriculture, commerce and other services. Second, the delay in the starting of infrastructure projects due to the ongoing corruption investigation, and third, the delay in the recovery of the private investment, mainly due to the two above mentioned issues.

With the Nino phenomenon now over, the estimates of its impacts include almost 200 thousand people demnified, more than 40 thousand houses destroyed, as well was 3,500 km of roads and more than 300 bridges. These figures are even bigger if we include also the partially affected people in houses, roads and bridges. As of the end of March, the financial system continues with low growth in loans reaching roughly three percent over the last 12 months with retail growing less than 5 percent and commercial remaining relatively flat. PDLs reached 3 percent at system level with cost of risk relatively stable at 2.2.

All of this has resulted in an impact in the financial system profitability of two full ROE points so far. Our prior estimates of loan growth of around 8-9 percent for the system seem difficult to be achieved as we see it today. We most likely be in the 4-6 area by year-end.

On the positive side, the government has approved a reconstruction program that should start to be executed in the coming months boosting public and private investments. This program will be pursued by a newly defined government unit that has autonomy to execute projects with simplified processes with the aim of accelerating the reconstruction which will demand approximately 20 billion soles as stated by the prime minister.

The reconstruction plan will be ready in three months, but certain rehabilitation projects have already been approved and should start briefly including 65 bridges, 1,500 schools, and 900 medical centers. Moreover, we expect a much better scenario for the financial system in the coming year. In line with the upward revision of GDP estimates for 2019, but the following quarters might still be weak.

As regards to the impact of El Nino on IFS, particularly on Interbank, we have around 1 billion soles in loans outstanding potentially affected. 40 percent, approximately, of which corresponds to commercial and SME loans, and 60 percent to retail loans. Within the commercial loan portfolio, the main sectors potentially impacted include transport, agriculture, commerce and construction, accounting for more than 80 percent of the total.

Limited impact on SMEs due to our low market share on the segment, accounting for less than 10 percent of the total loans potentially affected. Within the retail portfolio the total impact is still difficult to determine but includes credit cards, payroll loans and some mortgages.

The total amount of loans under the restructuring scheme approved by the superintendency as of the end of April is around 300 million soles, 7 percent of which is commercial and SMEs and 70 percent of which is retail loans, mainly credit cards.

Some additional clients have been identified as potential for entering the restructuring scheme during this month. The total impact on provisions for the year is still to be determined as the restructuring schemes mature and as we see how clients behave with respect to the payment capabilities during next quarter. We are monitoring it closely.

No additional impacts on Interseguro and Inteligo as Luis Felipe previously mentioned.

Now, we let me start the discussion of the quarterly performance by referring to pages two, three, four of the presentation. The main highlights are, at Interbank, loan portfolio growth was higher than the industry. The first quarter results were impacted by higher cost of risk and lower FX activity.

At Interseguro, results were impacted by annuity market dynamics and IFRs accounting discounting rate. Strong quarter at Inteligo, with activity revenues and profitability growing substantially quarter on quarter and year on year. IFS first quarter net profit reached 158 million soles, which is 160 percent increase year on year, but a 59 percent reduction quarter on quarter, mainly due to the impact of the discount rate in Interseguro's result as previously explained.

When looking at figures at IFS level, net interest and similar income increases 3.9 year on year, but decreases 0.9 percent on quarter on quarter, while fee income for financial services increases 6.8 percent year on year, but decreases 0.3 percent quarter on quarter. The quarterly decreases are mainly explained by seasonality factors and in the case of net interest income, to some extent, by the credit card portfolio.

NIM remains flat quarter on quarter at 5.6 percent, but NIM on loans at Interbank decreases 60 basis points to 9.4 percent mainly due to a higher growth in the commercial portfolio and the decrease in the weight of credit cards within the retail portfolio, together, with a decrease in the yield of the credit card portfolio.

PDLs increased 10 basis points reaching 2.6 percent on a quarterly basis at IFS level. Cost of risk increased 40 basis points quarter on quarter to 3.2 percent mainly due to an increase in credit cards. Efficiency improved 80 basis points on a quarterly basis down to 39.5 percent when excluding the impact of discount rates on technical reserves at Interseguro. Capitalization ratio for Interbank remains strong with total capital ratio at 17.1 percent.

Please turn to the following pages for a brief overview of the quarterly net earnings of IFS three segment. On page seven, talking about Interbank, performing loans grew 0.7 percent quarter on quarter and 1.5 percent when excluding the exchange rate impact as a result of a 1.7 percent increase in commercial loans, partially offset by a 0.3 contraction in retail loans. Growth in commercial loans was mainly due to increases in short and medium term lending partially offset by decreases in leasing operations and trade loans.

Retail loans decreased due to a 3.7 percent contraction in credit cards partially compensated by increases of 1.2 percent in mortgages and 1.2 percent in other consumer loans. Looking at the year on year performance, loans grew 4.4 percent year on year and 5.1 percent when excluding the exchange rate impact due to increases of 4.9 in commercial loans and 4 percent in retail loan.

Commercial loans grew mainly due to increases in trade loans and short and middle term lending, partially compensated by a reduction in leasing operations. Retail loans grew driven by growth of 5.6 percent in other consumer loans, 4.8 percent in mortgages and 1 percent in credit cards. In this context of low growth in the market we have been able to increase our market share on total loans 20 basis points on a quarterly and yearly basis.

On page eight, given the low growth in the loan portfolio, we have been focusing on trying to optimize our cost of funds as reflected by the 10-basis points improvement on a quarterly basis down to 2.8 percent by retaining the most cost-efficient deposits and letting go some corporate and institutional expensive deposits. This explains the quarterly decrease of deposits of 7.2 percent. In retail, the 1.7 percent decrease is mainly due to exchange rate impact. While the decrease in commercial and institutional deposits is mainly due to the strategy previously described which had an impact on our deposit market share.

On page nine, when looking at SBS comparable figures to the system, Interbank’s past loan due ratio increased 10 basis points on a quarterly basis reaching 2.7 percent and below the system average of three percent, and which increased 20 basis points in this same period. The coverage ratio remains strong at 174 percent. The same trends are valid for the IFRS PDL figures. When looking at the PDLs breakdown, we can see within retail that overall consumer credit PDL has increased 30 basis points quarter on quarter to 3.9 percent and is slightly above the system average.

Credit cards PDLs increased 50 basis points to 5.5 percent above the system average of 5.1 percent mainly due to both an increase in the past due loans and to a decrease of the credit cards portfolio of 3 percent in the quarter.

Within the commercial portfolio PDLs improved in corporate down to 0.5 percent and slightly increased both in medium and small and micro company but remained well below the system average.

The annualized ratio of provision expense to average loans has increased 40 basis points to 3.3 percent in this quarter. This ratio remains above the system average of 2.3, mainly due to the mix of our portfolio with a higher incidence of retail and credit cards when compared to the system and to the other big three banks.

The weight of our credit card portfolio is 16 percent on our total portfolio compared to 8 percent of the system. When looking at IFRS cost of risk figures, the trends remain the same.

On page 10, our portfolio has continued to de-dollarize with 74 percent of loans being soles denominated versus 68 percent of the industry. This is mainly due to two factors. We have a higher share of retail loans which are more soles based than commercial loans. Only 8 percent of our retail loans are dollar denominated.

Second, we have a higher soles based component in our mortgage portfolio within retail loans. Dollar denominated mortgages represent 15 percent of total mortgages and are down from 20 percent in the last 12 months.

On page 11, efficiency ratio stands at 43.3 percent with a slight deterioration versus prior quarter, mainly due to the decrease in revenues. Moreover, it is important to mention that in this quarter we have started to see the effects of higher expenses due to our technology investments including the outsourcing of our data center as well as other investment required for enhancing our digital efforts.

On page 12, as of this first quarter, Interbank's capital ratio is 17.1 percent. 500 basis points above its risk adjusted minimum capital ratio requirement established at 11.9 percent and above the system average of 15.8 percent. The minimum regulatory capital ratio requirement was 10 percent while the additional capital requirement for Interbank was 1.9 percent. Core equity Tier 1 ratio was 8.8 percent.

Please turn the following page to discuss Interseguro's result. On page 14 Interseguro's net result attributable to shareholders was a loss of 75.9 million which compares to 131.6 million profit in the fourth quarter and a loss of 135 million in the first quarter of the previous year. Interseguro's profit excluding discount rate impact on technical reserves was 3.8 million in this quarter compared to profits of 29 million in the fourth quarter of 2016 and losses of 47 million in the first quarter of 2016.

The quarterly decline in bottom line results was mainly explained by increases of 182 million in adjustment of technical reserves and 38.8 million in impairment loss on available for sale investments, partially off-set by 18.9 increase in net gain on sale of securities. The yearly improvement in bottom line results was mainly due to a 25 million increase in net gain on sale of securities in addition to a 16 million decrease in impairment loss in available for sale investments and 16 million increase in net interest and similar income.

On page 15, you can see a comparison with local GAAP results. Interseguro's net result in the first quarter was 22.7 million under local gap which compares to the 75.9 million loss under IFRS. The main differences between the IFRS and the local GAAP profits are as follows:

First, a higher adjustment of technical reserves under IFRS as a result of the use of a different weighted average discount rate to calculate technical reserves for annuities. Second, a lower net result on valuation of real estate investments under IFRS as result of the use of different discount rates to calculate NPV of real estate investment valued under DCF methodology.

Third, a higher profit in foreign exchange as a result of different dollar stock of assets and liabilities in IFRS when compared to local GAAP; and last, a lower result in impairment loss on available for sale investments, as under IFRS the book value of impaired security is adjusted to realize the gain or loss when sold.

On page 16, net premiums were 134.7 million in the first quarter, decreasing 14 million quarter on quarter and 42 million year on year. The quarterly reduction was mainly explained by a decrease of 12 million in annuities and 2.4 million in retail insurance. The annual decrease was mainly related to a market contraction in annuities due to the regulation implemented in April 2016 allowing retirees to cash out a significant portion of their pension fund. Annuity market share in the first quarter was 20.6 percent. Adjustment of technical reserves was 176.6 million compared to 5.7 million in the fourth quarter and 228 million in the first quarter. The quarterly growth was mainly due to different discount rating impacts in annuities. This rate increased by 17 basis points in the fourth quarter and decreased 16 basis points in the first quarter of this year.

The yearly increase was also a result of a different discount rate impact annuities decreasing by 21 basis points versus the first quarter of last year. Considering the factors previously explained, total premium earned less claims and benefits resulted in a loss of 125.8 million this first quarter, a decrease of 192.5 million quarter on quarter and an increase of 1.7 million year on year.

On page 17, Interseguro's investment portfolio reached 5.6 billion increasing 4 percent quarter on quarter and 9.8 percent year on year. The quarterly decrease was explained by a 38.8 million negative effect attributed to book value adjustment of previously impaired instruments which was registered in the fourth quarter of 2016 given the sale of such securities. Coupled with a decrease of 11.1 million in net gain of valuation of real estate investments. The yearly increase was largely explained by increases of 25.3 million in net gain on sale of securities, 16.4 million in impairment loss on available for sale investments and 16.1 million in net interest in similar income.

On page 19, we will start the discussion of Inteligo group results. Page 19, as previously mentioned, Inteligo had very positive results in this first quarter as well as in 2016, with a solid quarter in activity, revenues, efficiency and profitability. Inteligo's first quarter 2017 net profit reached almost 50 million soles a 27 percent increase quarter on quarter and a 60 percent increase year on year.

Inteligo's net interest and similar income in the first quarter was 25.8 million, a 20 percent increase when compared with the fourth quarter of last year. The quarterly result was mainly explained by higher income and dividends on investments available for sale and lower interest and similar expenses. Net interest and similar income increased by 4.9 percent when compared to the same period in the previous year. This result was attributable to the performance of income on investments available for sale partially off-set by higher interest expenses on the deposits and obligations.

Net fee income for financial services was 29 million, a decrease of 4.6 percent when compared to the previous quarter, but an increase of 19.6 percent when compared to the previous year. Inteligo's other income reached 10.3 million in this first quarter, registering a 9.8 percent decrease quarter on quarter, but a very strong increase year on year. While other expenses decreased 22.9 percent when compared to the previous quarter and decreased by 5.1 percent year on year, mostly explained by a reduction in administrative expenses due to lower third party related services.

On page 20, assets under management plus deposits reached 14.5 billion in the first quarter, a 2.3 percent decrease when compared to the previous quarter, but an 8.6 percent increase when compared to the first quarter of the previous year. The quarterly growth rate was negatively affected by a 3.2 percent appreciation of the exchange rate quarter on quarter as funds managed denominated in dollars.

When looking at dollar figures, assets under management plus deposits grew both quarter on quarter and year on year. Inteligo's loan portfolio reached 1.7 billion in the first quarter, a 2.1 percent decrease quarter on quarter and a 1.3 percent decrease year on year. Loan portfolio is also denominated in dollars which grew 1.1 percent in dollar terms quarter on quarter.

Revenues generated by Inteligo were 68 million, a 7.2 percent increase quarter on quarter and 33.6 percent increase year on year. Inteligo's bank fee income divided by assets under management increased to 1 percent in the first quarter.

Inteligo's net profit was 49 million while annualized ROE was 28.2 percent, higher than the 23.6 percent reported in the fourth quarter and the 20.5 percent registered in the first quarter of the previous year.

A final remark, since our last conference call, there have not been any additional purchases of own shares under the share repurchase program announced on May last year.

Now we welcome any questions you may have.

Operator: At this time, if you would like to ask a question, please press the star and one on your touchtone phone. You may remove yourself from the queue at any time by pressing the pound key. Once again, that's star and one to ask a question. We will pause for a moment to allow questions to queue.

Our first question from Carlos Rivera with Citi.

Carlos Rivera: Hi good morning. Thank you for the presentation Michela, my first question is regarding loan growth. We saw a 4 percent increase in the loan book, particularly driven by the commercial segment you gained market share there. Just wondering if you could give us a little bit more color there. What is driving this, was this like a one large item ticket? What are you differently from competitors to get market share there? Do you think that it is sustainable?

My second question would be regarding loan loss provisions. I know it is probably early to assess the full impact of El Nino, but if you could clarify if you booked anything extraordinary due to that in this quarter. That would be appreciated. Thank you very much.

MichelaCasassa: Thank you Carlos for your question. First related to loan growth, this growth is actually being spread between the three different segments that we manage. We are growing both in corporate clients, middle market clients and also on our SME segment. Basically, on our large corporate and mid-size clients, we've been pursuing a pipeline of deals, which came into place in this quarter. Basically, we are being close to our clients and also trying to understand which needs they might have also coming from the current scenario that we are living; and related to our SMEs clients we did a restructuring in the way in which we serve clients at the end of last year.

Basically, now we have our relationship managers at our stores. This change has helped us to revert a trend of decreasing loans that was in place last year. Starting September last year, we started to grow in this SME segment and we have continued to do so also this segment which is also helping the growth that you have seen at the end of the first quarter. We've seen a little bit of recovery in this activity, basically we are experiencing similar trends as of April and this start of May.

Related to your second question on loan loss provisions, basically as I mentioned in the script, it is really very difficult to determine today what can be the impact on provisions for this year. Some of the clients that we have included in the restructuring scheme have been restructured for 30, 60 or 90 days. We will only be able to understand the exact impact once those restructuring schemes mature.

We have not included any additional provisions specific for El Nino in this first quarter. As we still have under our stock of provisions a portion of voluntary provisions that we did last year and also all of the stock of the pro-cyclical provisions that we have continued to build even after the rule of pro-cyclical provisions deactivated many months ago. Let's say that we feel that we could face some of the additional impact that could come in the next quarter with that.

Carlos Rivera: Can you just remind us please of the amount of excess provisions that you have created in the past? How much is that, please?

Michela Casassa: The voluntary provisions that we built at the end of last year were roughly 40 million.

Carlos Rivera: Thank you very much.

Michela Casassa: Plus, the pro-cyclical provisions that we also have on stock.

Carlos Rivera: Okay.

Operator: We will take our next question from Guilherme Costa with ITAU BBA, your line is open.

We will take our next question from Jason Mollin with Scotiabank, your line is open.

Jason Mollin: My question is focused a bit on going forward looking at loan growth and the reactivation, hopefully, in the second half or maybe next year, the economy and looking at the retail side. What will it take to a return to more robust loan growth for retail? Give us how you think that will evolve. My second question is a follow up to the exposure to El Nino. You mentioned approximately a billion soles in exposure. What percentage of that billion is already reserved in stock? Thank you.

Michela Casassa: Hello, Jason. Thanks for your question. First related to loan growth, when we discussed this issue some months ago, we were expecting a scenario in which the system could grow between 8 and 9 percent. This was a scenario which was expecting a recovery of the economy or a strong recovery of the economy in the second half of the year. As we stand today, we believe that scenario is very difficult to be achieved. We have revised our guidance to 4 to 6 percent loan growth to the system and we will try to be at least in line with that.

Between commercial and retail, what we are seeing today is a recovery of the commercial growth, but still the retail side is hit by the slowdown in the economy. We believe that will continue for one or two quarters. We will need to see this after with the total impact of El Nino also. What we are envisioning today is a recovery during 2018, but still a couple of quarters with weak performance.

As regards to El Nino, as I mentioned, we have this 1 billion of potentially affected portfolio. Basically this 300 million of these clients we have included under the restructuring scheme which are the ones that we have been able to either contact one by one or through some massive restructurings, but we have not constituted any specific provisions for these clients as we have not identified any specific case, yet, that would indicate that there is need to do so.

That of course, will have to be reviewed and we are monitoring week by week in order to see the behavior and the payment capability of these clients in the coming months after the restructuring schemes mature.

L. Felipe Castellanos: It's Luis Felipe and just add on to Michela's comment of that billion that are exposed to the areas where El Nino hit actually, a big portion is commercial. We don't foresee much trouble on that portfolio. We've been close to those companies. Mainly in the transport in the agriculture sectors we have not seen anything that really worries us. On the retail front, as Michela was mentioning, it's a matter of keeping close to our customer base, while the reprogramming matures, we will be able to assess in a more detailed way what exactly can be the impact.

Jason Mollin: Is it based like a general comment about the loan loss reserves on the balance sheet, the stock, is what I was trying to ask. Is that typically for these kinds of loans, especially in the retail sector, would be 10 percent of the balance? Would it be 15 percent? During the process of granting the loans, you created loan loss allowances of some amount on the balance sheet that are already there.

L. Felipe Castellanos: The way it works is we book a percentage for every loan we grant. When underwritten, it is around 1.5 percent. As Michela mentioned, for special situations we have the pro-cyclical provisions we have booked that are around 150 million level right now. They are intact and we have not used them and we continue to constitute.

Then depending on the classification of the loan or the customer, we move to higher levels of provisioning.

Michela Casassa: Jason, if I can add a couple of numbers. Our stock of provisions as of the first quarter is 1.2 billion and the coverage ratio that we have is 174 percent. That 1.2 billion of stock of provisions includes the 150 million that Luis Felipe was mentioning of pro-cyclical provisions and the 40 million voluntary provisions that we mentioned before.

Jason Mollin: Great, understood.

Operator: Once again, that is star and one to ask a question. There are no more questions at this time. I would like to turn the program over to Mrs. Casassa for any closing remarks.

Michela Casassa: Thank you everybody for joining the call and we hope to see you all during our second quarter call in August. Thanks.