IFS 2Q09 Conference Call
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9:30AM CT

Operator: Welcome to the Intergroup Financial Services Second Quarter 2009 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 that time, instructions will be given as a procedure to follow if you would like to ask a question. It is now my pleasure to turn the floor over to Peter Majeski of i-advize Corporate Communications. Sir, you may begin.

Peter Majeski: Thank you, Operator, and good morning, everyone. Welcome to Intergroup Financial Services Second Quarter 2009 Earnings conference call on this, the 5th of August, 2009.

We are very pleased to have with us from Intergroup Mr. Jose Antonio Rosas, chief financial officer, Ms. Claudia Valdivia, chief financial officer of Interseguro, and Mr. Gonzalo Basadre, investment manager of Interseguro. They will be discussing Intergroup's results to the press release distributed yesterday. If you have not received a copy of the results or updated earnings presentation, please visit www.ifs.com.pe to download a copy or call us in New York at 212-406-3694.

Before we begin, I would like to remind you that any forward-looking statements made today by Intergroup's management are based on information and data currently available and are subject to various conditions that may differ materially. It is now my pleasure to turn the call over to Mr. Jose Antonio Rosas, Intergroup's chief financial officer. Mr. Rosas, you may begin.

Jose Antonio Rosas: Thank you very much Pete. Good morning everyone, and welcome to Intergroup's Second Quarter '09 conference call. We will start with a brief discussion of the highlights of Intergroup's performance; that's the first page in the presentation. Intergroup's net earnings were 128.7 million nuevo soles in the second quarter of '09, equivalent to earnings per share of 1.37 nuevo soles. That's up 32 percent increase year on year and 82 percent increase quarter on quarter.

Results were driven by strong contributions from both subsidiaries from Interbank and Interseguro. Earnings growth was mainly attributable to higher financial income at Interbank and Interseguro and lower funding costs at Interbank. Interbank's net earnings rose 49 percent quarter on quarter and 35 percent year on year to reach 101.7 million in the second quarter of '09. The main driver for earnings growth at Interbank was a significant increase in gross financial margins as a result of higher financial income and lower funding costs.

Financial income rose 34 percent year on year led by higher loan volumes and yields and nine percent quarter on quarter as a result of realizing investment gains. The average funding cost declined by 40 basis points year on year and 60 basis points quarter on quarter as a result of a higher proportion of low cost deposits in the funding mix and a reduction in short-term interest rates carried out by the Central Bank.

Efficiency improved significantly at Interbank, as costs remain stable while revenues increase. Despite an increase in delinquencies in credit card loans, asset quality remain strong with a past due ratio of 1.7 percent, in-line with the Peruvian banking industry average. At Interseguro, 43 million soles in net earnings in the second quarter of '09, a nearly 8 fold increase quarter on quarter and 15.5 percent in year on year. Now, year on year with the results of lower technical margin loss due to higher premium sales and lower claims. The quarter on quarter earnings growth was due to a 114 percent increase in investment income.

Please turn to the following page to discuss the summary of Intergroup's profit and loss statement. On that page, we can see that gross financial margin for Intergroup grew 28 percent quarter on quarter as a result of higher investment income in Interbank and Interseguro and lowering funding costs at Interbank. Year on year growth in gross financial margin was 30 percent due mainly to higher loan volume and yields at Interbank. Growth margin remained stable for quarter on quarter, but more than doubled year on year, driven party by higher loan volume and partly by an increase in consumer notes.

As a result of this increase, net financial margin grew 13 percent year on year and expanded by a significant 37 percent quarter on quarter. Fee income grew 22 percent year on year and jumped 1 percent quarter on quarter due to lower corporate banking at Interbank. Expense growth was much more moderate than in previous quarters, at nine percent year on year and four percent quarter on quarter. Due to an increase in growth financial margin and stable expenses, net earnings grew 32 percent year on year and 82 percent quarter on quarter. Please turn to the following page.

In the next page, we have a summary of net earnings for Intergroup and its two subsidiaries. We can see that Interbank and Interseguro posted significant earnings growth rates and contributed to Intergroup's strong second quarter. As a result of both subsidiaries' performance, Intergroup's ROE was 34 percent, significantly above 19 percent in the previous quarter.

Now, let's turn to a detailed discussion of Interbank's performance. In Interbank's summary profit and loss statement, we can see some of the same trends we have discussed in Intergroup's P&L. Gross financial margin grew 34 percent year on year driven by higher volumes and past due loans and by lower funding costs. While provisions more than doubled, net financial margins still grew at a solid 19 percent year on year and net earnings to increase 27 percent year on year. Gross financial margin grew 21 percent quarter on quarter driven by a higher return on investment and by a 50 basis point decline in the average funding cost. We fee income and operating expenses remain relatively level and stable, net operating margin grew 40 percent for the quarter and net earnings expanded by 60 percent quarter on quarter.

Please turn to the following page. There we can see some numbers for loan growth at Interbank. We can see that the pace of loan growth slowed during the second quarter of '09; in fact, total loans at Interbank declined 2.7 percent quarter on quarter, due mainly to a 6.7 contracted in commercial loans. During the same period, retail loans increased by one percent. The decline in the commercial loan portfolio was due to a more competitive market environment than in the previous quarter and a slow demand for credit in the corporate sector.

Year on year growth in the bank's loan portfolio was still very high at 29 percent, with similar growth rates in the commercial and retail segment. The market share of total retail loans has increased from 16.2 percent in June '08 to 16.7 percent in June '09, gains have taken place in the consumer loan segment. In commercial banking, the market sales expanded from 7.1 percent in June '08 to 7.6 percent in June '09.

Now, please turn to the following page to discuss the sources of funding at Interbank. As a result of slower loan growth, Interbank reduced its use of institutional bank deposits and short-term bank borrowings. As a result, bank deposits fell 10 percent quarter on quarter and total retail deposits declined by four percent. Short-term borrowing fell 29 percent, while long-term bank debt rose 32 percent particularly as a result of the successful placement of a securitized transaction for a total of $121 million in June of this year. While deposit growth has slowed from the previous two quarters, the share of deposits in the bank funding remained very high at 82 percent in the second quarter of '09, up from 76 percent in the second quarter of '08.

Now, please turn to the following page for a discussion of Interbank's gross financial margin. Gross financial margin rose 39 percent year on year, driven by a 34 percent in financial income and a 40 basis points decline in the average cost of funding. Year on year growth in financial income was mainly driven by a 48 percent increase in interest on loans. This growth was due to a 41 percent expansion in the bank's average loan volume and an increase of 70 basis points in yield.

Additionally, investment income growth rose 85 percent mainly due to a realized gain in the bank's investment portfolio totaling 40 million nuevo soles. Financial expenses decreased 20 percent year on year as a 35 percent expansion in the average volume of interesting bearing liabilities was offset by a decline in the average cost of funding from 3.6 percent in the second quarter of '08 to 3.2 percent in the second quarter of '09. The main driver for this decline was a higher proportion of deposits within the funding mix and lower short-term interest rates.

Looking at the quarter on quarter performance, we can see that gross financial market increased 21.5 percent as financial income grew 9.3 percent, while financial expenses declined 17.7 percent. Financial income growth was driven by a 117 percent increase in investment income which was due a realized gain on our investment portfolio as I said before. Interest from loans grew by 1.5 percent quarter on quarter due to a 40 basis point rise in the average yield, which was partially offset by a .9 percent decline in the year on year volume of loans. Financial expenses fell 17.7 percent due to a significant decline in the average cost of funding from 3.8 percent in the first quarter of '09 to 3.2 percent in the second quarter of '09. The main drivers for this decline were much lower rates on time deposits and short-term borrowing.

Please turn to the next page. The chart on that page shows that Interbank’s recurring net interest margin increased by a significant 90 basis points quarter on quarter as a result of higher loans and investment yields and lower funding costs.

Please turn to the following page where we discuss asset quality and provisions. In the chart on the right, we can see that asset quality continues the slight deterioration in this quarter as a loan ratio rose from 1.5 percent in the first quarter of '09 to 1.7 percent in the second quarter of '09. This ratio is in-line with the banking industry average and is partly the result of slower growth in Interbank loan portfolio and is party due to rising delinquencies in consumer loans. But coverage remains high at 2.7 percent of pass-due loans and that is above the banking industry average of 200 percent. The chart on the left shows that loan provision expenses as a percentage of average past due loans increased slightly quarter to quarter so 4.2 percent to 4.5 percent as a result of higher provisional expenses in the consumer loan segment.

Please then turn to the following page to discuss Interbank's fee income. Fee income rose 23 percent year on year driven by increase in fees from the credit card business, ATM use, deposit accounts, interest loans, and professional services and declined 3 percent quarter on quarter mainly as a result of lower fees in the commercial banking business, particularly the corporate side.

Please turn to the following page to discuss Interbank's expenses and distribution network. In the first chart on this page, we can see that growth in the bank's distribution network was much slower than in the previous two years as anticipated and that is a continuation of a trend we've seen in the previous quarter. As a result of the slower expansion, expenses have doubled and are growing at a much more moderate rate than in 2008. Operating expenses rose 9 percent year on year and only 1.6 percent quarter on quarter. This led the efficiency ratio to improve significantly from 58 percent in the second quarter of '08 and 54 percent in the first quarter of '09 to 48 percent in the second quarter of '09.

That is a summary of Interbank's performance. Now, I will turn the call over to Claudia Valdivia, CFO of Interseguro who will discuss Interseguro's performance.

Claudia Valdivia: Good morning, please turn to the next page of the presentation. A table shows the summary of Interseguro P&L performance where we can see a quarterly growth of Interseguro's net income of 23 million nuevo soles. This quarterly increase was due to a significant improvement on investment income and we will give more detail later on in this presentation. On a yearly basis, the growth in income was 15.5 percent higher due to a significant improvement in technical margins, explained by an increase in annuity fees.

The next page of the presentation shows in detail the performance in Interseguro's premiums. As we can see, premiums increased 14.5 percent quarter on quarter and 37.9 percent year on year. The most relevant changes during the second quarter of 2009 are the following: Annuity premiums increased 33.3 percent quarter on quarter and 49.8 percent year on year. This increase is explained by a market growth of 12 percent year on year and market share gains of 7 percent year on year and quarter on quarter.

Group life premiums grew 25 percent year on year mainly due to an increase of life insurance premiums tied to mortgage credits and disability and survivor benefit premiums decreased significantly percentage-wise but not on an absolute basis. These premiums are related to Profutro's contract that ended in December of 2007.

Finally, the next page of the presentation shows some details on Interseguro's investment portfolio and investment income. Interseguro's investment income was 42.8 million nuevo soles in the second quarter of 2009, a significant increase over the first quarter of 2009, but a small decline compared to the second quarter of 2008. The yearly decrease is explained by gains realized in the second quarter of 2008 in our fixed income and equity portfolio. On a quarter on quarter basis, the growth is explained by fixed income and equity trading because of increases in prices of Peruvian sovereign debt and stocks on the Lima Stock Exchange.

Interseguro's investment portfolio increased 8.2 percent year on year totaling 1,838 million nuevo soles. The additional funds received were invested mainly in equity and mutual funds on real estate loans.

Jose Antonio Rosas: Thank you, Claudia. So, now we can open the discussion to questions and answers.

Operator: At this time, we will open the lines for questions. If you would like to ask a question, please press "star one" on your telephone keypad now. Again, that's "star one" on your telephone keypad if you would like to ask a question. Our first question comes from Daniel Abut with CITI.

Daniel Abut: Good morning, Daniel Abut from Citi in New York. My question has more to do with a general macro question then how, depending on your answer, is translated into your outlook on the bank. Are you seeing any signs the economy is bottoming out and, therefore, is it reasonable to expect a much better second half of the year than the first half?

I'm not referring to the bottom line per se, which really was good in the second quarter, but things like the asset quality cycle eventually is reaching an end and loan growth becoming more pronounced. Is it too early to tell whether we are seeing a recovery in the second half, or is it more reasonable to expect it in 2010? What indication are you seeing in the economy?

Jose Antonio Rosas: Good morning, Daniel. I think it's still too early to tell as you mentioned. We have all seen the economic performance and that segment has been much slower than initially expected and we're still not seeing the strengthening of our recovery.

We're seeing lots of signs within the economy in terms of consumer demand, sales and we are expecting an increase in government spending during the following months, which should lead to a mild recovery during the second half of the year.

With that being said, what we are seeing at Interbank is that asset quality trends have stabilized during the last couple of months. So we are not expecting any further or significant deterioration reduction in terms of asset quality. We should have that same provision expense, the same provisioning ratio as we have seen in the last quarter.

Daniel Abut: So, for the second half of the year, we should expect provisions to remain somewhere near the 4 or 5 percent of average loans. Right?

Jose Antonio Rosas: Yes, that is what we should expect.

Daniel Abut: And with respect to loan growth, we didn't see much on quarter on quarter basis this quarter. Are you, should we expect some kind of a pick-up in the second half or not at this time?

Jose Antonio Rosas: Oh, yeah. We certainly didn't see much growth particularly in the commercial banking segment and that was surprising to us because we were expecting that there would be a much higher loan growth rate in the commercial banking segment.

What we have is to keep margins very high as you have seen, spreads very high, keeping our NIM up. That's what we will concentrate on doing the second half. We will not be fighting for market share with lower margins or lower spreads so we might not see significant growth as initially expected, but we do expect to have very high margins going into the second half of the year.

Daniel Abut: Thank you, Jose Antonio.

Jose Antonio Rosas: Thank you, Daniel.

Operator: Okay. Our next question comes from Marcelo Telles with Credit Suisse.

Marcelo Telles: Hi. Good morning, everyone. My question is actually a follow-up on the first question. If you look at net interest margin and exclude the trading gains in the quarter, there was definitely an increase from first quarter. Do you believe there is room for further increases in that interest margin for the second half of the year and, if so, what would be the main drivers for that? Thank you.

Jose Antonio Rosas: Good morning, Marcelo. We think that there is room for improvement and that will depend mainly on the Central Bank's monetary policy. If the Central Bank continues to lower rates as expected, then we will definitely see more room for improvement in margins.

Marcelo Telles: Just an additional question. Your funding structure improved quite substantially in the quarter, do you think that increase in retail deposits is sustainable? Should we continue to see that at least a similar funding mix for the rest of the year? Thank you.

Jose Antonio Rosas: Yes, we do expect to maintain a similar funding mix throughout the year.

Marcelo Telles: Thank you.

Operator: Our next question comes from Sergio Matsumoto with Santander.

Sergio Matsumoto: Hi. Good morning. My question is on the Interbank side. How comfortable do you feel with the pace of expansion of your distribution network? And where do you see this going in the next six to twelve months? And my second question is on the Interseguro side. What is driving the growth in the annuity sales? If you could please give us more color on that.

Jose Antonio Rosas: Okay. First for your question on Interbank, we are very comfortable with the rate of expansion of our distribution network. We had a two-year project, which entails doubling our branch and ATM network between 2006 and 2008. We successfully completed that project and we were always expecting to return to more organic growth after that and that's what we're doing now, growing at a much slower pace, both in terms of the number of branches and ATM's. In fact, branch growth now is strongly related to the growth in our affiliate, Supermercados; we an agreement with that company and we're opening full service branches in the Supermercados is opening. Those are small sites, low-cost, full service type of branches that we will continue to expand in as Supermercados continues to grow. Now, for, Claudia will answer the question related to Interseguro.

Claudia Valdivia: Regarding increasing the annuity premiums, basically as we explained in the presentation, the increase is explained by a market growth of 12 percent year over year and market share gains of 10 percent quarter over quarter and year over year. These market share gains, we are seeing these market share gains basically because we have been working to improve our sales force productivity through increasing training and a more effective compensation scheme and we obtained these as a result during the quarter.

Sergio Matsumoto: And for the market growth in the annuities segment?

Claudia Valdivia: Well, basically as I mentioned, it grew 12 percent year over year and has been pretty much stable quarter over quarter, so we expect not a greater growth in the market.

Sergio Matsumoto: I see. Thank you very much.

Operator: As a reminder, if you would like to ask a question, please press "star one" on your telephone keypad now. Again, that's "star one" on your telephone keypad if you would like to ask a question. Our next question comes from Carlos Rojas with Compass Bank.

Carlos Rojas: Thank you. My question was already answered.

Operator: Okay. Thank you, sir. Our next question comes from Daniel Abut with CITI.

Daniel Abut: Just a quick follow-up, Jose Antonio. In this quarter, clearly the bottom line was favored by the realization of those gains being made into the loan portfolio and those are realized gains, you took them; so the question is, do you still have more of those gains to come as you have retained part of the portfolio in bonds that you bought at the right time or in the meantime has the entire portfolio has been sold by now?

Jose Antonio Rosas: No, we still maintain a large part of that portfolio, that was a large portfolio bought in 2006 and 2007, which we have been holding on to as a positive carry for us and was just an opportunity to sell at the moment we saw the interest rates were favorable for us, but we still have a significant portion of that Peruvian global bond portfolio and we continue to monitor the market for an opportunity of realizing those gains.

Since those assets are classified on our books as available for sale, any unrealized gains are not mark to market in our P&L, they are only registered as gains when they are realized. So, we could expect to see some continuation of that trend; it will depend on how we see market conditions.

Daniel Abut: Thank you, Jose.

Operator: Okay. Our next question comes from Julio Dittdorn with Megeve Investments.

Julio Dittdorn: Hi. Good morning, everyone. Can you be more detailed on the loan growth for the retail sector, especially because we have seen a flat growth quarter over quarter? My concern is are you being more restrictive on quality for that person or is this just a market nature decline of flat growth?

Jose Antonio Rosas: Good morning, Julio. The reason for flat growth in our retail portfolio is different among the different types of credits, but it has mostly to do with the market risk. The market in general has been flat in terms of retail loan growth in the last quarter.

Having said that, we have become more strict in our policy for new credit cards branded at Interbank. However, we have also seen a decline or stagnation in consumer demand within our existing credit card numbers. So, we are seeing, I would say in credit cards there is a combination of more strict credit policies and also slower consumer demand as a result of slower use of our credit cards.

Within the payroll loan segment, which comprises a last part of our total retail portfolio, we have not taken any additional steps to restrict our credit quality. It's just a market demand factor and the same goes for mortgage loans. Mortgage demand have been particularly slow during the first half of this year and we are seeing some signs that demand for mortgage loans have picked up in the last couple of months. So there we should see some growth coming up in the next month.

Julio Dittdorn: Okay. Thank you. But can you expand a little bit more on your restrictive policy of leaving these credits? What are you looking for right now? Are you looking for employment, for new issues when you are granting a personal loan?

Jose Antonio Rosas: Yes, but just in credit cards and it is basically lower lines of credit for the same standards. People who got a line of credit of 100 six months ago will now get a lower line of credit given that person has the same standard of credit risk.

Julio Dittdorn: Okay. Thank you.

Operator: Again, if you would like to ask a question, please press "star one" on your telephone keypad now. Again, that's "star one" on your telephone keypad if you would like to ask a question. Okay, sir, at this time, there are no further questions in the queue. So, Mr. Rosas, I'll turn things back to you for closing remarks.

Jose Antonio Rosas: Yeah. Thank you very much and thank you all for participating in Intergroup's second quarter '09 call. Good-bye to all.

Operator: This concludes our teleconference. You may now disconnect your lines.