3Q16 IFS Conference Call
Transcript
November 10, 2016

Operator: This is the Intercorp Financial Services third quarter 2016 Conference Call. Good morning and welcome to Intercorp Financial Services third quarter 2016 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 to the procedure to follow if you would like to ask a question. It is now my pleasure to turn the call over to Rafael Borja of I-Advize Corporate Communications. Sir, please begin.

Rafael Borja: Thank you, Katie, and good morning everyone. On today's call Intercorp Financial Services will discuss its third quarter 2016 Earnings. We are very pleased to have with us Mrs. Michela Casassa, Chief Financial Officer of Intercorp Financial Services, Mr. Juan Pablo Segura, Chief Financial Officer of Interseguro and Mrs. Claudia Valdivia, Chief Financial 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 of the earnings, it is now available on the Company's website www.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 Mrs. Casassa, Intercorp's Chief Financial Officer for her presentation. Mrs. Casassa, please go ahead.

Michela Casassa: Good morning, and welcome to Intercorp Financial Services third quarter Earnings call. We will start the presentation on Page 2, where we will be discussing a summary of IFS results.

IFS third quarter 2016 net profit was 208.7 million soles, a 17.2 percent growth quarter on quarter but a 48.9 percent reduction year on year. The quarterly performance was mainly explained by a 10.9 percent growth in profits at Interbank resulting from lower provision expenses. The yearly decline in profits was mainly a result of higher requirements of technical reserves at Interseguro due to a lower discount rate on annuities and a decrease in foreign exchange gains at Interbank due to a particularly high trading activity in the third quarter of last year that was not repeated in this quarter. Excluding discount rate impact on technical reserves, IFS third quarter results grew 23 percent quarter on quarter and 2.3 percent year on year, and excluding also the negative impact of lower trading activity in FX at Interbank, IFS's third quarter net profit would have increased 25.3 percent year on year.

At Interbank, the third quarter net profit was 221.5 million soles, a 10.9 percent increase quarter on quarter, but an 8.6 percent decrease year on year due to the previously mentioned reasons, which made other income decrease 39.4% year on year. Excluding such effects, profits for the Bank would have grown 16 percent year on year. At Interseguro, third quarter result was -54.3 million or 24.5 million excluding discount rate impact on technical reserves, which represents a recovery of 25.6 million quarter on quarter and a decline of 4.1 million year on year.

At Inteligo, the third quarter net profit was 48.4 million, a 9.8 percent decrease quarter on quarter, but a significant recovery year on year. The quarterly performance was attributed to a seasonal 15.8 percent decrease in interest and similar income, partially compensated by an 8.6 percent growth in other income and lower expenses.

On Page 3, you can see a summary of the key quarterly indicators for IFS. Net interest and similar income increased 1.8 percent quarter on quarter and 5.4 percent year on year. The quarterly and yearly increases were mainly driven by Interbank and partially offset by Inteligo and Interseguro. Fee income from financial services increased by 1.7 percent on a quarterly basis and 2 percent on a yearly basis mainly due to a strong performance at Interbank, partially offset by a decrease in Inteligo due to an extraordinary high third quarter 2015. NIM remained flat quarter on quarter at 5.6 percent, while NIM on loans at Interbank improved 10 basis points to 9.9 percent. PDLs remained flat on a quarterly basis at 2.5 percent at IFS level and cost of risk improved substantially by 50 basis points quarter on quarter down to 2.6 percent mainly due to an improvement in consumer lending. Credit cards PDL ratio improved 80 basis points in the third quarter down 4.4 percent and below the system's average of 4.6 percent. Efficiency ratio was 40.9 percent and has been impacted by Interseguro's results for the high level of technical reserves due to the negative impact of interest rates. Excluding such effect, efficiency ratio would have been 37.9 percent, relatively flat versus previous quarters. Capitalization ratio for Interbank remains strong at total capital of 16.1 percent.

Please turn to the following pages for a brief overview of the quarterly net earnings of IFS's three segments. Before entering into the details of Interbank results, we'd like to give you a short update of the banking industry which is impacting the Bank's results but which has allowed us to gain market share in many of our products. First, there has been a slowdown in loan growth in the industry with loans growing only 3 percent year-to-date and 6 percent year on year as of September 2016. Retail loans grew 4 percent year-to-date and roughly 8 percent year on year, while commercial loans grew 2 percent year-to-date and roughly 4 percent Year on year. Cost of risk has increased 10 basis points at system level over the last 12 months to 2.1 percent and results from financial operations have decreased 34 percent year on year at system level with a strong decrease in foreign exchange trading gains. When looking at Interbank's figures, Interbank profits reached S. 221.5 million in the third quarter with a quarterly growth of 10.9 percent. This quarterly growth was mainly due to S. 30.4 million lower provision expense and an increase of S. 9.9 million in fee income from financial services.

The annual decrease in net profit was explained by a reduction of S. 55.5 million in other income and an increase of S. 39.4 million in provisions. These factors were partially offset by an increase of S. 33.4 million in net interest and similar income and S. 15.1 million in fee income, in addition to a lower effective tax rate. Interbank's ROE was 22 percent in the third quarter, higher than the 21.3 percent reported in the second quarter, but lower than the 28.2 percent registered in the third quarter of 2015. NIM decreased 10 basis points in this quarter to 5.9 percent, but NIM on loans improved 10 basis points to 9.9 percent. The decrease in NIM was mainly due to higher returns on investments in the previous quarter, while the improvement in NIM on loans was mainly due to a higher yield on the portfolio mix.

On Page 7, performing loans grew 1.4 percent this quarter due to increases of 2.1 percent in retail loans and 0.5 percent in commercial loans. Retail loans increased due to growths of 3.9 percent in credit cards, 1.4 percent in mortgages and 1.3 percent in other consumer loans. Commercial loans grew mainly due to higher trade finance loans and short- and medium-term loans, partially offset by lower leasing operations. Performing loans grew 5.7 percent on a yearly basis due to increases of 8.6 percent in retail loans and 2.7 percent in commercial loans. Retail loans growth was driven by increases of 9.4 percent in mortgages, 8.7 percent in other consumer loans and 7.5 percent in credit cards. Commercial loans grew mainly due to increases in short- and medium-term lending partially offset by lower trade finance loans and leasing operations. Our market share on total loans decreased 10 basis points on a quarterly basis, but increased 20 basis points in consumer lending.

On Page 8, Interbank's total funding base increased 8 percent on a quarterly basis, mainly due to growths of 9.8 percent in deposits, 4.2 percent in due to banks and Interbank's funds, and 3.5 in bonds. The quarterly growth in deposits was mainly explained by increases of 17.1 percent in institutional deposits and 15.5 percent in commercial deposits. The Bank's total funding base increased 5.2 percent on a yearly basis. This increase was due to growth of 8.5 percent in deposits and 4.3 percent in bonds, partially offset by a 6.2 percent contraction in due to banks and inter-bank funds. The yearly growth in deposits was mainly explained by increases of 20.2 percent in commercial deposits and 13.0 percent in retail deposits, partially offset by an 18.4 percent decline in institutional deposits. As a result, the portion of deposits to total funding increased from 68 percent in the third quarter of the previous year to 70.2

percent in this quarter, while the proportion of institutional deposits to total deposits decreased from 22 percent to 16.7 percent in the same period. The yearly contraction in due to banks was mainly due to a reduction in funding provided by the Central Bank. Our total deposit market share increased sharply during the quarter by 80 basis points, and the yearly increase in market share of retail deposits reached 60 basis points.

On Page 9, when looking at SBS comparable figures to the system, Interbank's past-due-loan ratio was 2.6 percent in this quarter, and the coverage ratio remained strong at 177 percent. The same trends are valid for the IFRS PDL figures. When looking at the PDL breakdown, we can see within retail that overall consumer credit PDLs have improved 40 basis points on a quarterly basis, down to 3.3 percent and below the system average of 3.5 percent. Credit card PDLs have improved substantially or 80 basis points down to 4.4 percent and below the system average of 4.6 percent. Mortgages increased its PDL ratio by 10 basis points to 3.2 percent, in line with increase of the PDL ratio of the system. Within the commercial portfolio, PDLs remained relatively stable and below the system average. The annualized ratio of provision expense to average loans improved 30 basis points, down to 2.8 percent in the third quarter of this year. This ratio remains above the system average of 2.0 percent, 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. Normalizing this effect of our portfolio mix, our cost of risk ratio would be at 2.1 percent. When looking at IFRS cost of risk figures, the improvement in the ratio is even bigger or 50 basis points.

On Page 12, Interbank's capital ratio of 16.1 percent was 420 basis points above its risk adjusted minimum capital ratio requirement established at 11.9 percent. The minimum regulatory capital ratio requirement was 10 percent, while the additional capital requirement of this quarter was 1.9 percent.

Please turn to the following page to discuss Interseguro's results.

On Page 14, Interseguro's net results attributable to shareholders in the third quarter was -54.3 million, which compares to -56 million in the second quarter and 156.2 million in the third quarter of the previous year. Normalized results, excluding discount rate impact on reserves and FX transaction impact, was 29.1 million, 31.1 million better than the second quarter and 38.6 percent higher than the third quarter of the previous year. The quarterly improvement was mainly explained by 70.3 million decrease in impairment loss and available-for-sale investments, registered as other expenses, partially offset by a 31.3 million reduction in net gain on sale of securities, registered as other income, coupled with a 28.1 million increase in adjustment of technical reserves, and a 5.5 million impact on foreign exchange translation results. The yearly decline in profits was mainly due to a 116.9 million increase in adjustment of technical reserves, in addition to a 77.8 million decrease in net premiums and a 35.1 million decrease in net gain on sale of securities. These factors were partially offset by a 44.3 million decrease in impairment loss on available-for-sale investments.

On Page 15, you can see a comparison of Interseguro's IFRS results with local GAAP results. Interseguro's net profit attributable to shareholders in the third quarter was minus 54.3 million under IFRS and positive 25.6 million under local accounting standards. The main differences between the two are as follows: First, a higher adjustment of technical reserves under IFRS as the result of the use of a lower-weighted average discount rate to calculate technical reserves for annuities. Second, a higher net gain on valuation of real estate investments, as under IFRS they are considered at fair value. Third, a lower profit from sale of investment property, as under IFRS gains are measured against market value whereas local GAAP gains are measured against cost. Fourth, a lower profit in foreign exchange as a result of different US dollar stock of assets and liabilities in IFRS and local GAAP. And last, higher profit on sales of investments that had previously registered imparirment losses under IFRS.

On Page 16, net premiums were 136.2 million, an increase of 6.1 million on a quarterly basis due to a 3 million growth in annuities and 2.6 million in retail insurance; but a decrease of 77.8 million year on year, mainly related to a market contraction in annuities, due to the new law that entered in force in April this year, allowing retirees to withdraw 95.5 percent in their pension funds. Annuities market share year-to-date was 23.3 percent, which positioned Interseguro as the market leader. Adjustment of technical reserves in this quarter was 163.6 million, a 20.7 percent increase on a quarterly basis and 250 percent increase on a yearly basis. The quarterly growth was mainly due to a different discount rate impact in annuities. This rate increased by 9 basis points in the second quarter and by 12 basis points in the third quarter. The year-on-year increase was also the result of a different discount rate impact in annuities. This rate increased by 33 basis points in the third quarter of last year, but decreased by 12 basis points in the third quarter of this year. Net claims and benefits incurred in third quarter of this year was 78.7 million, a 4.9 percent quarterly increase and 14.3 percent yearly increase. The quarterly growth was mainly due to an increase in retail insurance, and the yearly growth was mainly explained by higher annuities pension. Considering the factors previously explained, total premiums earned less claims and benefits resulted in -106.1 million in the third quarter, a decrease of 25.7 million quarter on quarter and 204.6 million year on year.

On Page 17, in the third quarter, Interseguro's investment portfolio reached 5,634 million, an increase of 5.7 percent on a quarterly basis, and 20.9 percent on a yearly basis. Results on investments in the third quarter were 106.8 million, which represented a 7.8 percent return on Interseguro's investment portfolio, above the 5.1 percent reported in the second quarter, but still slightly below the 8 percent registered in the third quarter of the previous year. The quarterly and yearly growths were largely explained by decreases of 70 million and 43 million in other expenses, respectively. These effects were partially offset by decreases of 29.6 million and 34.2 million in other income, and decreases in other expenses were explained by high levels of impairment loss on available-for-sale investments in the second quarter and in the third quarter of the previous year.

On Page 19, we will start with the discussion on Inteligo Group's results.

Inteligo's net interest and similar income in the third quarter was 19.8 million, a 26.7 percent reduction when compared to the second quarter. Net interest and similar income decreased 13.3 percent, compared to the same period in the previous year. These results were attributed to lower income on investments available-for-sale and higher interest expense on deposits and obligations. Net fee income from financial services was 31 million, a slight decrease when compared to the previous quarter, but when compared to the third quarter of the previous year, net fee income from financial services decreased 16.9 percent, mainly attributable to a decrease in fund management income, partially offset by a decrease in fee income expenses. Inteligio's other income reached 17.8 million in the third quarter, an 8.6 percent increase quarter on quarter, mainly due to a higher net trading gain partially offset by lower net gain on sale of securities. Other income reverted positively when compared to the third quarter of last year. The result was attributable to recoveries in net gain on sale of securities and in net trading gains. Other expenses decreased 2.2 percent when compared to the previous quarter as a result of a reduction in salaries and employee benefits. Inteligio's other expenses decreased 26.6 percent year on year, mainly explained by an impairment loss on available-for-sale investments reported in the third quarter of the previous year. Excluding such charge, total other expenses in the third quarter were 5.6 percent lower year on year. As a result, Inteligo's net profit in the third quarter was 48.4 million, a 9.8 percent decrease quarter on quarter but a significant recovery year on year.

On Page 20, assets under management plus deposits reached 14,605 million in the third quarter an 811 million, or 5.9 percent increase when compared to the previous quarter, and 2,250 million, or 18.2 percent increase when compared to the third quarter of the previous year. Inteligo's loan portfolio increased 5.4 percent quarter on quarter and 4.2 percent year on year. Revenues generated by Inteligo reached 69 million, an 8 percent decrease quarter on quarter, but a strong 54.5 percent increase year on year. Inteligo Bank's fee income divided by assets under management increased to 1.1 percent in the third quarter.

To finalize the presentation, **on Page 22,** we can summarize the key takeaways as follows. At Interbank, slower growth, given current market environment; 13 percent year on year growth in retail deposits led to a 60 basis points gain in market share on such segment. PDL ratio improved 10 basis points quarter on quarter, remaining below the system's average. At Interseguro, premiums recovered quarter on quarter after the annuity market stabilized after the new regulatory environment, however, still below the last year's levels. Results from investments improved quarter on quarter and year on year, mainly due to sale gains on available-for-sale investments as impaired securities recovered, and a strong double-digit annualized growth in the investment portfolio both quarter on quarter and year on year. At Inteligo, assets under management plus deposits increased 5.9 percent quarter on quarter and 18.2 percent year on year. Normalized results on the investment portfolio drove revenues up 54.5 percent year on year, and net profit increased more than twofold year on year. At IFS, profits increased 17.2 percent on a quarterly basis due to strong core results at Interbank and Inteligo, and on a yearly basis net income continued to be negatively impacted by higher requirements of technical reserves at Interseguro due to a lower discount rate on annuities, in addition to lower net gain from foreign exchange transactions at Interbank. Before your questions, we would also like to give an update on the Stock Repurchase Program that we approved last May 25th in our Shareholder's Meeting. Since our last conference call, when we already gave an update on the buyback program, Interbank has bought 1 million IFS shares. This means that as of today, the total number of shares acquired from both IFS and Interbank since the launch of the program is 1,441,000 shares. Now we welcome any questions you may have.

Operator: Thank you Ma'am. At this time, we will open the floor for questions. If you would like to ask a question, please press the * key followed by the 1 key, that is *1 on your touchtone phone now. Questions will be taken in the order in which they are received. If at any time you would like to remove yourself from the questioning queue, please press *2. Again, that is *1 if you would like to ask a question. Our first question comes from Carlos Rivera from Citi.

Carlos Rivera: Hi, good morning everyone and thanks for the presentation, Michela. A couple of questions from me. The first one is regarding asset quality. Very good improvement in this quarter on provision for loan losses, 3.1 percent going down to 2.6 percent. Is there anything extraordinary here, maybe high recovery? We obviously saw some improvements in the past-due-loan ratio for the segment and consumer and wholesale. I'm just wondering what are trends that you are seeing for the past-due-loan ratio and for the provisioning cost. That would be my first question and I'll ask the second one after. Thanks.

Michela Casassa: Good morning, Carlos. Regarding asset quality, as you can see on

Slide No. 9, this is coming mainly from the retail banking as we have seen a recovery in the PDL ratio of especially credit cards. Credit cards is a product where we have been let's say, growing slowly during the last 12 months. Okay? And there have been a series of measures that we have been undertaking in order to try to focus more on the best credit risk profile clients. So basically this has been an improvement especially in the months of August and a little bit in September, but is a trend that we need to continue to track over the next month given that the market itself is not growing very much. We believe this is the result of the measures we've taken in our underwritting standards, in our collection capabilities. We've seen a slight recovery also in the delinquency ratios of recoveries and it's something that we are still working on and we need to see also what continues to happen over the next month.

Carlos Rivera: Okay, so you would say that probably the 2.6 percent cost of provisioning that we saw this quarter is roughly some of the normal level?

Michela Casassa: We shouldn't go back to the previous levels that we registered during the previous quarters.

Carlos Rivera: Okay, great. And my second question is regarding the net interest margin. A flat quarter on quarter, of course, being pressured by interest expenses that continue to go up, so I'm just trying to understand what should we expect for the NIM on a more normalized scenario for the currency? Is the spread on Soles denominated loans higher than US-denominated loans, or if that is the case should we expect that once the FX stabilizes we could see a positive effect of the NIM because of the de-dollarization of the economy. Is this the right way to see it? Any color there would be great. Thank you.

Michela Casassa: Regarding NIM, what we are foreseeing is to have a relatively stable NIM. Of course, that is going to be the result of different driving forces as you were saying, more Soles, but also a different impact on the portfolio mix. So basically, we are expecting a slight recovery of commercial loans, for commercial loans what we are expecting is also a recovery of midsize companies and small businesses. That should help on one side. Then with an increase in rates, we believe we should be able to transfer that to a portion of the clients but not necessarily to all of them. Okay? So that could put some pressure on both dollar and Soles margins and we are also expecting specially by year-end and the beginning of next year lower growth of mortgages due to the prepayments coming from the funds liberated by the new regulation on private funds, okay, which should decrease a little bit the proportion of mortgages to total retail loans. No? So that is another force that we go on the positive trend. So putting everything together we are betting more on a stable NIM for the upcoming months.

Carlos Rivera: Okay, great. Thank you very much.

Michela Casassa: Thanks for your question.

Operator: Thank you. Our next question comes Alonso Aramburu from BTG.

Alonso Aramburu: Hi, good morning and thank for the call. I wanted to ask you Michaela about loan growth which has picked up in credit cards growth in this quarter. Should we expect this kind of growth to continue? And what are your expectations for 2017 for overall loan growth for Interbank. And my second question regarding Interseguro, we saw an improvement on the annuity performance growing quarter on quarter. Have we seen the worst in annuities? Do we think will it start growing from this lower base from the longest if you could give us a little bit of color in that respect. Thank you.

Michela Casassa: Good morning, Alonso. Related to loan growth, I commented at the beginning of the call the loan growth that we are seeing at system level. No? It's a loan growth that we didn't see in a long time and basically we are expecting in 2017 which is slightly better than what we are seeing this year, not as much better as we would have expected because still we see that it's taking some time to pick up. Okay? Basically, if this year ends up growing roughly 6 percent total loans, we would be more in the line next year at system level may be growing an 8 percent, which is still not a fantastic growth. And we think that there will be different things going on different directions again because of the impact that the regulation on private pension funds has had on the mortgage portfolio. But we expect a slight, let's say, recovery on the rest of the retail portfolio and on the commercial portfolio when compared to this year. What we would like to do is always try to grow a little bit faster than the system growth so we should be expecting the bank to grow a little bit higher than the 8 percent of the system. And relating to annuities I am going to ask Juan Pablo who is sitting here with me to give you an answer.

Juan Pablo Segura: Hi, Alonso, good morning. Short answer to your question, yes, we think we've reached the bottom in terms of the annuity market. When we see the quarter on quarter performances, I would say three-fold performance reasons why the annuity margin is going up. One, we have all these backlog of retirees that are taking their decisions now to go into annuities that were helding their decisions in the last couple of quarters. The share of annuities of the available funds of retirement has gone up again, not back to the 80 percent we had pre-law, but much higher than the 5 percent that we had in the last couple of quarters. That's a good indication that the annuity market is recovering and has a potential of keeping the growth for next year. And the other side of the coin is the disability and survivorship market, that's almost half of the market of annuities. That was not impacted by the law and that's growing at high single digits quarter on quarter and almost double digits year on year. I think we've seen the bottom and we should expect annuities market go up in the next quarters, still lapping Q4 and Q1 versus last year, but starting Q2 next year, we should start seeing a positive number there.

Alonso Aramburu: Okay. Thank you very much.

Operator: Thank you. Once again if you would like to ask a question, please press *1 at this time. We are now holding for questions. Again, that is *1 if you would like to ask a question. Our next question comes Luis Adaime from Newfoundland Capital Management.

Luis Adaime: Hi everyone. Just a question concerning your capital ratios. They seem relatively higher than usual for this year, now considering lower credit growth for this year and, you know, a scenario of not that much more growth for next year. Are you considering ramping up your buyback program, or should we expect a higher dividend payout ratio? How are you seeing that asset capital situation?

Michela Casassa: Actually today, we are standing at high total capital ratios, so the 16.1 percent that I commented which is also above the system average. Speaking about the ratio of core equity Tier 1 we're roughly standing at a 9 percent core equity Tier 1 ratio. So basically we are keeping these two ratios and what we are expecting for next year is that as growth resumes slightly, we would continue to be okay with the regulatory requirements, but we are not thinking on changing the policies that we have applied in the past related to this issue.

Luis Adaime: Got it. Okay, thank you very much.

Michela Casassa: Thanks.

Operator: Once again, we are now holding. Please press *1 if you would like to ask a question. At this time I am showing no questions in the queue. I would like to turn the call back over to Mrs. Casassa for closing remarks.

Michela Casassa: Okay, thank you everybody for joining us during this quarterly call and we'll see each other in the next quarter call, thanks.

Operator: Thank you. Ladies and gentlemen, this concludes today's conference. You may now disconnect.

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