VI. Conference Call Transcript

IFS 4Q08 CONFERENCE CALL
FEBRUARY 4, 2009
9:30 A.M.

OPERATOR: The following teleconference is for Peter Majeski with i-advize on Wednesday, February 4, 2009 beginning at 8:30 a.m. Central Time. Welcome to the Intergroup Financial Services Fourth Quarter 2008 Earnings conference call.

Good morning ladies and gentlemen, my name is Kallie and I will be your conference operator today. 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 Kallie and good morning everyone. Welcome to Intergroup Financial Services Fourth Quarter 2008 Earnings conference call on this 4th of February, 2009.

We are very pleased to have with us from Intergroup, Mr. Jose Antonio Rosas, Chief Financial Officer, and Mr. Ernesto Gonzalez Quattrini, Investor Relations Officer. They will be discussing Intergroup's results to the press release distributed yesterday.

If you have not yet received a copy of the earnings report or the 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. Ernesto Gonzalez Quattrini, Intergroup's Investor Relations Officer. Mr. Gonzalez, you may begin.

ERNESTO GONZALEZ QUATTRINI: Thank you Pete. I want to welcome all of you to Intergroup's quarterly conference call, and thank you in advance for your interest and attention. Also, with us today are Gonzalo Basadre, Investment Manager of Interseguro, and Claudia Valdivia, CFO of Interseguro, who will be available for comments regarding investments and different questions especially during the Q&A session.

Intergroup's underlying business and operating performance was strong in 2008, although the global financial crisis and strict regulations and reserve requirements on provisioning resulted in a 10% decline in the earnings in 2008.

Net earnings at Intergroup grew 46% quarter-on-quarter after we saw a very solid operating trends at Interbank. However, earnings fell 6% year-on-year due primarily to valuation losses related to Interseguro's equity portfolio, as well as higher return reserve requirements at Interbank. Excluding non-recurring items, net earnings at Intergroup rose 4% year-on-year and 1% quarter-on-quarter.

Regarding our subsidiaries, Interbank and Interseguro; Interbank's net income grew 19% in 2008 mainly driven by increased financ ial income d erived from a higher loan portfolio. Net income grew 32.1% quarter-on-quarter and 15% year-on-year as a result of incre ases in int erest on lo ans and the incom e. Interbank's l oan p ortfolio grew 51% year-on-year and 15% q uarter-on-quarter leading to signific ant gains in market share. The average yield on loans remains stable quarter-on-quarter and NIM increased slightly despite lower returns on reserve deposits held at the Central Bank.

Asset quality and coverag e remain str ong, with p ast due loans at 1.2% of total loan s, below industry standards and coverage at 283%, about the industry's average. However , provision expenses doubled quarter over quarter, primarily as a result of new pro-cyclical provision requirements.

Interseguro reported 6.5 million Soles in 2008, significantly below the 79 million Soles reported 2007 as a result of losses in th e valuation of the investment portfolio. Val uation losses totalled 22 million Soles in fourth qu arter '09, as I nterseguro's 221 million Soles' equity portfoli o, equivalent to 12% of th e company's total investment portfolio, lost 17% of its value in fourth quarter "08, affected by a 37% dro p in the Lima Stock Exchange index.

As a result, I nterseguro reported a 7.3 million Soles net loss in f ourth quarter '08, an improvement ov er the 16 million Soles l oss reported in third quarter '' 08. I would now like to turn the call to Mr. Jose Antonio Rosas, Chief Fin ancial Officer of Intergroup , who will b e discu ssing the comp any's quarterly results in depth. Jose Antonio?

JOSE ANTONIO ROSAS: Thank you Ernesto. Please turn to page four of the presentation for a brief summary of Intergroup and our sub sidiaries' pe rformance du ring 2008. We can see there that Intergroup's net earnings were close to 250 million nuevo soles in 2008, that's a 10% decline from 2007. This decline was due to a significant drop in Interseguro's earnings from 69 million nuevo soles in 2007 to 6.5 million. This decline was due to valuation losses in Interseguro's investment portfolio. Interbank, on the other h and, had a v ery str ong per formance with net earnings growing by 19% in 20 08, driven by significant loan growth.

On page five we c an see a summary of the qu arterly performance of b oth subsidiaries. Net incom e at Intergroup increased 47% quarter -on-quarter drive n by improv ements in t he con tributions of b oth subsidiaries. Please turn to the f ollowing page to discuss the P &L of Intergroup in more detail. As mentioned, I ntergroup's net earning s grew 47% q uarter-on-quarter; one of the main dri vers of that growth was an increase of 22% in gross financi al margins. This increase was due to higher interest on loans and lower investment and exchange losses at Interbank.

This increase in the gross financial margin was offset by a significant rise in provisions, affected primarily by new pro-cyclical provisi on requirements set by th e banking superintendent. As a result, net financial margin declined 4% quarter-on -quarter. Despite thes e declines, net operating margin grew 24% due to an 11% increase in fee income, and a significant reduction in the loss of Proseguro's underwriting.

Our income and expenses fell from an unusually high level in the third quarter of '08, when during that quarter we h ad sever al provisions th at were revers ed. This dec line in our in come and expenses was more than offset by a tax gain due to an increase in the first half of the year at Interbank. As a result, net earnings grew 46% and the main drivers were a higher gross margin, an improvement in insurance underwriting, and growth in the consumer sector that was partially offset by higher provisions and higher expense. Net income fell 7.4% year-on-year after a significant growth in gross margin was offset by low loan provisions and investment losses at Interseguro.

On page seven, we can see some detail on the c ontribution of both t he k ey are as to Intergroup's earnings. And there, we can see from a quarterly basis, both Interbank and Interseguro's contributions improved quarter-on-quarter. Interseg uro and Inte rbank's contri bution grew 24%, while Intersegur o's loss declined from 60 million Nuevo soles in the first quarter of '08 to 70 million Nuevo soles in the fourth quarter of '0 8. On a yea r-on-year ba sis, Interb ank's contributi ons increased 18%, whiles Intersegur o declined from a profit of 7 million Nuevo soles in th e fourth quar ter of '08 to a loss of 7 million Nuevo soles in the fourth quarter of '08. As a result of th at reversal at Intersegur o, earnings at Intergroup fell 5% year-on-year, but increased 47% quarter-on-quarter.

Please turn to page nine f or a discussion of Interb ank's performance. On page nine, we have a summary of Interbank' s yearly perf ormance in 2008. Net earnings incr eased 19%, driven by higher financial income from an expanding volume of loans. Net financial margin grew 33% as revenue from a loan book that grew 61% was partially offset by the growth of higher reserve requirements led by the Central Bank.

Provisions grew 86%, driven by stricter requirements from the regulator, higher loan growth and a slight decline in credit quality at the end of the year . Fee income gr ew 36%, driv en by a l arger number of transactions and expenses grew 33% due primarily to th e bank's expansion. As a result earnings before taxes grew 8 0% percent, while the income tax expens e totalled 1 6% due to an increase in deferred tax assets leading to net earnings to grow by 19% in 2008.

On page 10 , we can see detail of Interbank's quar terly P&L statement. Interbank's net i ncome grew 32% quarter-on-quar ter, d riven by a 26 % increase i n gr oss fin ancial margin . This increase in financi al margin was due mainly to loan gr owth, higher inc ome fr om an exp anded loan por tfolio, and al so, to lower investment and exchange losses in the fourth quarter.

There were two big non -recurring item s th at affected re sults and offset earnin gs in the fou rth quarter . One was a r equirement t o register ne w particular provisions led by the ba nking superintendent in December of last year. This caused a one-time im pact of 25 million Nuevo soles in Interbank's provision expense in the fourth quarter. The other non-recurring item was a 36 million tax gain due to an increase in deferred tax assets associated to the expenses that are not currently considered deductible by the tax authority, but will be deductible when those expenses, which are generic now, become real. Net earnings grew 15% year-on-year, driven by financial margin gr owth and were partially of fset by higher provision s and expenses.

Please turn to the following page. We can see that loan growth continued to be strong during the fourth quarter with retail loans expanding by 9% quarte r on quarter and commercial loans growing by a significant 21 %. We had a very good quarter in our comm ercial division with significant efforts to capture market share in that sector.

As a result of this strong fourth quarter, year on year growth was 61% for our total l oan book with with retail l oans g rowing 49% and comm ercial loans growin g 61% . As a result of thi s significant r ate of growth, our market share on retail loans expanded on 14.2% in the fourth quarter of '07 to 16.1% in the fourth quarter of '08. That's nearly 2% point gain in market share.

Please turn to page 12 now. There we can see that total deposit growth was 2.5% quar ter on quarter and 32% year on year. While growth was in total de posits were small on a qu arterly basis, if we break down the components, we can see that core r etail deposits grew at a much rapid rate, 27% quarter on quarter and 51% year on year. As a result of this significant growth in retail deposits, our market share expanded from 11.1% in September '08 to 11.8% in December '08 and that is in the retail deposit sector.

Commercial deposit f ell, primarily as a resul t of l ower in stitutional dep osits from foreig n investment. Those deposits are now subject to significant reserve requirements from the Central Bank. A s a result, it is no longer profitable for the bank to continue holding onto those deposits.

The bank's additional fun ding needs to in the fourth quarter were covered with past due l oans and an issue of subordinated loans that took place in October of last year.

On page 13, we can see the evolution of our net int erest margin. There we c an see that our NIM was 7% in the fourth quarter of '08, slightly above the 6.9% in the previous quarter. This improvement was primarily due to a recovery in the yield of our investment portfolio at Interbank.

Please turn to page 14. Then we can see that asset quality remains very strong with yield ratio p ast due loans to current loans at 1.2% and reserves coverage around 300%. Those ratios have remained stable throughout the year. However, the pr ovision expense increased significantly, due in large part to new provisioning standards by the Peruvi an regulator. This new, p ro-cyclical requirement wi ll significantl y increase the generic provisioning req uirements on normal loans. And th ere are n ew provisioning requirements depending on the type of loan. Consumer loans, for instance, provision requirements went up from 1% t o 2.7%. Other components of our in crease in the loan provision expense during the fourth quarter were volume growth in our loan book and a sl ight increase in the delinquencies in our consumer loan book.

Please turn to page 15 to see the composition of our gross financial margins. There we can see that total financial income grew 25% quarter on quarter and 42% year on year. That's a very strong performance, driven primarily by growth in income on loans. Income on loans grew 14% quarter on quarter, driven by 13% expansion in averag e loan volum e and a 10 basi s point inc rease in the average yield on our loan book.

Growth was 68% year on year on financial income alone, driven by a 61% expan sion in the volume of our loan b ook and a 60 basis point increase in yi eld. Investment income grew 56% quarter on quarter, driven by a significant improvement on yields. In the third quarter of '08 we had losses on our sovereign position at Interbank. We realized that loss in the third quarter and so we no longer had similar loss in the last quarter of the year. However we're still continuing to have a yield on our portfolio that is lower than what we had last year. As a result, our income on investment fell year on year.

The following lines in our financial income is interest on taxes, and there, we had a signifi cant decline, 19% quarter on quarter despite a 12% growth in volume. The reason for that decline were much lower yields on t he deposit s hel d at the Ce ntral Bank as reserve re quirements. Those dep osits are p aid according to LIBOR rates and the declining LIBOR has led to the decline in our financial income.

As a result of all those things, financi al income grew 25% quart er on quart er and 42 % y ear o n ye ar. Financial expenses grew 18% quarter on qu arter and 55% y ear on year, driven primar ily by higher volumes of d eposits and bank loans an d obligations required to cover the growth in our loan book and the higher reserve require ments set by the Centr al Bank. Gross f inancial margin, as a result, incr eased 27% quarter on quarter and 38% year on year . Th is increase was offset by the higher provision requirements that we have already discussed.

On page 16, we can see the detail of our fee inc ome. We can see that fee income growth continues to be very strong at 11% quarter on quarter and 23% growth year on year. This growth is driven primarily by a higher volume of business at our credit card division, and also new bu siness generated at our commercial banking division in foreign exchange and continuing lines of credit.

Page 17 has some detail s of our distribution netw ork expan sion and the operating exp enses that we resulted from that expan sion. We c an see th at we had a very active f ourth quarter last year . The number of branches going up from 175 at the end of the third qu arter to 207 at the end of the fourth quarter. We had a similar expansion in the number of ATM's. Despite the significant expenses, operating expenses have remained stable throughout the year, throughout the last three quarters at Interbank. As a result of that, our efficiency ratio has declined from the previous three quarters and it's currently at 55%.

Please turn to page 19 now to see an assessment of Interseguro's results. On page 19, we have a summary of Interseguro's yearly performance and there we can see, as mentioned before, that we had a significant decline in net earnings in 2008. Our technical margin remains stable, a slight improvement in the accounts driven by much lower claims, offset by lower premiums and higher reserves. But that was completely offset by a much lower investment income and that along with the global financial crisis and its impact Interseguro's fixed income and equity portfolio.

On page 20, we can see a summary of Interseguro's quarterly P&L. And there we can see we had a significant improvement in the technical margin in the fourth quarter of '08, both compared to the fourth quarter of '07 and to the third quarter of '08. That improvement is due to much lower claims and much lower reserves at Interseguro. Administrative expenses were lower year on year and also slightly lower quarter on quarter. And investment income was much lower than in the fourth quarter of '07 and slightly lower than in the fourth quarter of '08 and there are some details on that later on in the presentation. As a result, Interseguro posted a net loss of 7 million Nuevo soles, which was a reversal from a similar profit in the fourth quarter of '07, but a significant improvement from a 16 million Nuevo soles loss in the third quarter of '08.

On page 21 we can see some detail on Interseguro's premium sales. We can see that premium sales fell 8% year on year, driven primarily by much lower sales in the disability and survivor benefit lines and that decline was due to the fact that Interseguro stopped managing a key account, a pension fund manager on that line. The other premium lines at Interseguro posted significant gains in sales on a yearly basis.

On a quarterly basis, however, sales were lower on most of our lines. The only exception was group life insurance which grew 23%. The other lines were lower as a result of market price declines in consumer sales. However, Interseguro continued gaining market share across its key lines of business during the fourth quarter.

Finally, on page 22, there are some details on Interseguro's investment portfolio and investment income. As mentioned, investment income was 7 million nuevo soles in the first quarter of '08, a significant decline from the fourth quarter of '07 and a slight decline from the third quarter of '08. You can see the components of our investment income at Interseguro. Our fixed income yield was much higher in the fourth quarter of '08 than in the third quarter, there was significant recoveries in that line. Our equity and mutual funds returns on the other hand, posted a higher loss in the fourth quarter than in the previous quarter. Our equity portfolio lost 17% of its value, as mentioned already by Ernesto, compared to a 37% decline in the Lima Stock Exchange index.

And the final line of our income component is the investment income is real estate and there we continue to post significant deals and good appreciation in value. We had an exchange rate loss in the fourth quarter due to a devaluation of the nuevo sole. Compared to exchange rate gain in the first quarter and that led investment returns to be lower in the fourth quarter of '08 than in the third quarter of '08. However, the core components of our investment income were much better in the fourth quarter of '08 than in the third quarter of '08, with the exception of equity, which was driven by a significant decline in the Lima Stock Exchange as previously mentioned. So that's the end of the presentation and now we are open to a question and answer session.

OPERATOR: Okay, at this time we'll open the lines for questions. If you would like to ask a question, please press the star key followed by the one key on your touchtone phone now. If at any time you'd like to remove yourself from the questioning queue, you may press star-two. Again that's star-one to ask a question and star-two to remove yourself from the queue.

Our first question comes from Alonso Aramburu from Santander.

ALONSO ARAMBURU: Yes, good morning Antonio. I was wondering if you were going to give us a bit of an outlook of your view of an outlook for '09 as far as volume growth, which has been very, very strong and if it's going to be more toward the corporate sector or the retail sector.

And also what you see for margins, which have been coming down in the last quarters, but I would suspect, that with the lower reserve requirement, there would be less pressure on those.

JOSE ANTONIO ROSAS: Good morning, Alonso. Our outlook for '09 is not the same this time as it was a year ago. So we see a good opportunity in the market to continue gaining market share.

Having said that, we do not foresee and an expansion in our loan book as significant as that in the last two years; we grew 40% in '07, 61% in '08. We definitely foresee much lower rates of growth this year.

And what we see is that we have gained significant market share already in the consumer loan segment and, to a minor degree, in the mortgage loan segment. So there we will probably grow i- line with the market. Where we will try to gain market share and probably expand at a higher rate than our original book in the commercial segment.

Now going to your question about margins, we definitely foresee an improvement in margins in '09. First because of the lowering of the reserve requirements by the Central Bank as we already mentioned, and second because we are increasing our margins in commercial loans and in mortgage loans as well.

ALONSO ARAMBURU: Great, thank you. I guess, one final question; what do you expect as far as growth of your network for '09?

JOSE ANTONIO ROSAS: In terms of the network expansion, we have had a significant project that was to double our network in two years, from '06 to '08. It was always perceived that that would be a one-time significant effort and that, when completed, we would return to more normal growth rates. Now we are entering those more normal times and our expansion will be much, much less more conservative than in the previous two years.

ALONSO ARAMBURU: Great, thank you.

OPERATOR: As a reminder, if you would like to ask a question please press star-one on your telephone keypad now. Our next question will come from Andrea Schneider with Compass.

CARLOS ROJAS: Jose Antonio, it is Carlos Rojas, how are you? I have one question about Interbank and one question about Interseguro. About Interbank, I just want to see if you can give us a little more detail about where are you going to get the funding for your growth for next year, if it's going to be internal or if it's going to be from foreign sources? And if you can clarify a little bit about the past due loans on the credit card business, if it has been growing much or has it been stable?

And in Interseguro, we saw that real estate you have 425 million Soles going to 406. If you can clarify that is it the mark down on prices or if have you sold an asset? And what is your outlook on real estate prices for 2009? Thank you.

JOSE ANTONIO ROSAS: Good morning, Carlos. Regarding your questions about Interbank. Could you repeat that first questions regarding Interbank?

CARLOS ROJAS: Yes, my question was about you were expecting growth in line with the banking system in general. Where are you going to expect the funding? Is it going to come from the deposits, the retail side, that we saw you increase sharply or you are going to rely on the foreign lines that you had last year? And the other was about the credit card past due loans, if they have been rising or they have been steady for that year. That is it.

JOSE ANTONIO ROSAS: Okay. First of all, our main source of funding will continue to be deposits and particularly core deposits both in the retail segment and the commercial segment. We have seen a significant expansion in the deposits, as I've already mentioned. We do not foresee such a high rate of growth along the years, but we do foresee that retail deposits will continue to fund a significant part of our growth, particularly with our expanded branch network.

Recently we are working on some capital market issues, both locally and internationally. Naturally, the markets have seemed complicated but there are certain types of financing, medium term financing that are becoming accessible. So we are working actively on those.

Regarding credit quality and the credit card business, during the last quarter of last year we did see some increase in delinquencies. And as a result we had more write offs than we had in the previous months. It's not a big concern at the moment, but we do foresee that provisioning requirements have become higher in the credit card business. And now for the question on Interseguro, we have Gonzalo Basadre that will answer that question.

GONZALO BASADRE: Sure, first of all, I want to clarify that there is no markdowns in any of our real estate investments. The reduction comes from the sale of two plots of land that we have. They were going to be used for housing projects. We decided to better sell them to other developers and realized a gain there immediately and focus more on the commercial projects we have. Those are mainly for shopping malls, they have long term contracts, and we've been continuing investing in those. In fact, in December we inaugurated our shopping mall in Moncayos, which is a city in central Peru and it's been very successful.

CARLOS ROJAS: And do you have any idea of prices in real estate for 2009, are you worried about it or are you confident with your pricing?

GONZALO BASADRE: I don't see any, I mean, I don't see increasing prices in 2009. The real estate investments we have are, I would say, 90% not used for sale, but to rent and they have mainly long term contracts. So yes, we could have some reduction in prices in 2009, but it's not something that should affect us because we are not planning to have any significant sales contracts on real estate.

CARLOS ROJAS: Thank you.

OPERATOR: Thank you and if you would like to ask a question, please press star-one on your telephone keypad now. Okay gentlemen, there are no further questions in the queue. So I will turn the call back to management.

ERNESTO GONZALEZ QUATTRINI: Okay then. Thank you very much for joining us today for Intergroup's Fourth Quarter '08 conference call. I am the contact person at Intergroup regarding any information needs you may have going forward and my contact details are included both in the invitation you received for this call and in our company's website at www.ifs.com.pe.

We appreciate your time and interest and look forward to your continued attention. Good day to all.