Intercorp Financial Services

3Q23 Earnings

November 9, 2023, at 9:00 a.m. Eastern

CORPORATE PARTICIPANTS

Luis Felipe Castellanos – *Chief Executive Officer*

Michela Casassa – *Chief Financial Officer*

Claudia Delgado – Chief *Financial Officer, Interseguro*

Bruno Ferreccio – Chief *Executive Officer, Inteligo*

Valentina Porto – *InspIR Group*

PRESENTATION

Operator
Thank you for holding and good morning, and welcome to the Intercorp Financial Services Third Quarter 2023 Conference Call.

All lines have been placed on mute to prevent any background noise. Please be advised that today's call is being recorded.

After the presentation, we will open the floor for questions. At that time, instructions will be given as the procedure to follow if you would like to ask a question. Also, you can submit a question online at any time, using the window on the webcast and they will be answered after the presentation during the question-and-answer session. Simply type your question in a box and click “Submit Question.”

It is now my pleasure to turn the call over to Ms. Valentina Porto of InspIR Group. Ma'am, you may begin.

Valentina Porto
Thank you, and good morning, everyone. On today's call, Intercorp Financial Services will discuss its third quarter 2023 earnings.

We are very pleased to have with us:
Mr. Luis Felipe Castellanos, Chief Executive Officer of Intercorp Financial Services;
Ms. Michela Casassa, Chief Financial Officer, Intercorp Financial Services;
Ms. Claudia Delgado, Chief Financial Officer, Interseguro; and
Mr. Bruno Ferreccio, Chief Executive Officer of Inteligo.

They will be discussing the results that were distributed by the company, yesterday. There is also a webcast video presentation to accompany the discussion during this call. If you didn't receive a copy of the presentation or the earnings report, they are 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 InspIR Group in New York at (646) 940-8843.

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.

Please be advised that forward-looking statements may be made during this conference call. These do not account for future economic circumstances, industry conditions, the company's future performance or financial results. As such, statements made are based on several assumptions and factors that could change, causing actual results to materially differ from the current expectations. For a complete note on forward-looking statements, please refer to the earnings presentation and report issued yesterday.

It is now my pleasure to turn the call over to Mr. Luis Felipe Castellanos, Chief Executive Officer of Intercorp Financial Services, for his opening remarks. Mr. Castellanos, please go ahead, sir.

Luis Castellanos López-Torres
Thank you. Good morning and thank you for attending our third quarter 2023 earnings call. Let’s start with assessing the macro situation in Peru.

As we move on through the year, unfortunately, macro conditions have continued to deteriorate. The market expectation for a quick economic recovery has faded out. Businesses and consumers are adapting to the new growth outlook, but conditions have certainly taken a toll on credit conditions in the country. According to the latest survey of economic expectations from the Central Bank, GDP growth is expected to be close to zero this year and soft in 2024. El Niño poses a risk for a pickup in growth next year, but this will only depend on the magnitude of such climate phenomenon. We have taken certain actions in order to mitigate the possible negative impacts, as we will comment during the presentation.

It is worth to note that we remain optimistic on the country's mid-term prospects, as many of the factors affecting growth during the last months, we believe, are temporary, including political turmoil, the social unrest we faced earlier this year, the Yaku rains, the restrictive monetary policies after COVID, and even the potential El Niño.

On the positive side, inflation has decreased consistently in the last months, to such extent that the Central Bank has been comfortable to cut interest rates twice already and possibly for a third time later today. Inflation expectations for the next 12 months now lie very close to the upper limit of the policy target.

The Government appears to be reacting to the negative business environment and has started to make announcements on measures to boost the economy, but it is still early to call for a clear recoup of confidence and private investment and a better macro-outlook overall.

Moving to our business, even while facing this negative credit cycle period, IFS continues to deliver growth in terms of number of customers and revenues; and also we see progress in our digitalization efforts.

At Interbank, market shares across key business lines remain strong despite moderation in consumer loans. Here, payment behavior has deteriorated owing to the adverse macro variables mentioned. We are digesting increased levels of cost of risk, mainly in consumer loans. We remain well-provisioned and well-capitalized. We are committed to helping Peruvians to overcome these challenging times.

Separately, global market conditions continue to impact negatively on investment results in our Wealth Management business.

Our tight management of expenses over the years, and particularly during the last quarters, position IFS to face the current environment. Our efficiency ratio at 34% is one of our strengths.

At Interseguro, we see growth in premiums accelerating in individual life and retail insurance, while consolidating market leadership in annuities. Investment results continue to be solid in this company.

Finally, on Payments, despite growth in merchants, volumes have moderated this quarter. Izipay is working on creating synergies with Interbank, while PLIN continues to accelerate within a fully interoperable P2P system.

Summing up, we remain confident about IFS' outlook going forward and we believe that once we overcome this negative credit cycle and current macro conditions, midterm we will return to our path of target profitability and growth.

Now let me pass it onto Michela for a more detailed update of the results of the quarter.

Michela Casassa
Thanks, Luis Felipe. Good morning everybody, and welcome to Intercorp Financial Services third quarter 2023 earnings call. Today, we will review 4 sections of our earnings presentation, starting with the macro outlook for Peru.

On slide 3, complementing what Luis Felipe just mentioned, decrease in GDP and in inflation 3 quarters in a row has triggered the first cuts in soles rates in September and October, driving it down from 7.75% to 7.25%.

Inflation has decreased from a yearly 8.8% as of June 22 to 4.3% as of October this year, and exchange rate has been relatively stable, with a slight peak during October, which has reverted in the past days.

GDP remains the main concern, as shown on slide 4. This third quarter has changed the view from a recovery in the second half of the year to a more negative one, driving full-year 23 GDP estimates down to less than 1% and internal demand and private investments to negative territory.

On slide 5, during the last weeks, the probability of a strong Niño has surpassed for the first time the moderate view. We are already taking some actions to mitigate future impacts, which include reviewing our infrastructure for the safety of our employees and clients, further tighten our credit underwriting standards in the north and south of the country, reviewing potential impacts on our agro, fishing and transportation sector commercial clients and further focus on cost efficiencies. Additionally, we have already included some impacts of a moderate Niño in our forward-looking considerations for 2024, which has already impacted cost of risk this quarter by roughly 100 basis points.

On slide 6, in line with the previously mentioned macro scenario, we have further moderated banking activity by tightening credit standards, which had an impact in credit and debit card purchases as well as in retail and SMEs loan disbursements.

Reduced activity in banking and increased cost of risk in the consumer portfolio has impacted the banking earnings and ROE, while investment returns impacted Wealth Management results. With this, IFS earnings are at 195 million soles and ROE at 8.2%, driving cumulated earnings as of September to 793 million soles and ROE to 11.3%, as shown in slide 7.

Insurance continues to post good results in the quarter and in the year, while Payments continue to grow nicely but has seen a decrease in margins due to the competitive landscape with EBITDA still growing on a yearly basis. Both Insurance and Payments continue to gain market shares.

On slide 8, we are giving an update of the main operating trends and changing guidance for cost of risk and ROE.

First, we continue to register sound levels of capital with Core Equity Tier 1 ratio at 11.2% and Total Capital Ratio at 15%.

There has been a moderation in yearly total loan growth to 10% as of September and 16.6% in consumer loans, and a stabilization of NIM at 5.5% at IFS level.

We continue to see good efficiency levels, both at IFS and at the bank level, as we are strictly monitoring and managing costs, especially at the bank, which has reached a cost-income ratio below 37% as of September, a strong improvement versus last year, mainly due to the good operating leverage.

There has been a further increase in cost of risk coming from consumer lending this quarter, pushing the bank accumulated 9-month cost of risk to 4%, which already includes a first forward-looking impact from a moderate Niño, as previously mentioned. We are changing the guidance for cost of risk to reflect these new trends and the Niño impact to 4.2%-4.8%, as we expect a further increase in cost of risk in the fourth quarter.

IFS ROE as of September of 11.8% has been impacted by cost of risk at Interbank and soft investment results at Inteligo. We are changing the guidance for ROE to reflect these trends to 8%-10% for year-end.

Now, let's move to the second section of the presentation, which focuses on profitable growth.

On page 10, we see a continuous growth of customer base at IFS, or 13% on a yearly basis in Banking, 11% in Insurance, 9% in Wealth Management and 38% in Payment merchants.

On slide 11, good news in top line as total revenues continued to grow 7%, year-over-year, thanks to the growth registered in banking of 9%, Wealth Management recovering from negative territory one year ago and Payments growing 3%. Similar trends in top line when looking at cumulative results for the first nine months of the year.

On slide 12, we have seen a deceleration in banking fees, mainly related to credit cards and some commercial activity with a recovery in Wealth Management fees and flat fees in Payments.

On slides 13 and 14, we wanted to give you more details on the riskiness of the portfolio: 45% of Interbank's portfolio is focused on commercial banking, which continues to behave nicely, mainly due to our conservative approach, which has always focused on low-risk clients and has had a small participation in small and micro companies. This conservative approach has allowed us to maintain a lower PDL versus our peers to balance our higher focus in the riskier consumer portfolio.

On the consumer portfolio, we have three different risks: first, the unsecured consumer portfolio, which is the one being impacted by the macro scenario and which represents 23% of the total loan book; second, mortgages at 21% of the loan book; and third, payroll deductible loans to the public sector employees, a low-risk segment, which represents 11% of the total loan book.

This quarter, cost of risk of the bank reached 5%, which considers an impact of 100 basis points from a moderate Niño included in the forward-looking update and an increase in the retail cost of risk to 8.1%. Coverage ratio for the retail portfolio remains high at 221% and above pre-COVID levels. Commercial banking cost of risk has seen a slight increase in cost of risk with stable coverage ratio.

We have granted an increased number of reschedulings in the consumer loan book to help customers better cope with their payments as we are seeing a deterioration at system level, which includes over-indebtedness of families, sustained high level of food inflation and more contraction of the economic activity. These reschedulings, as seen on slide 14, represent 18% of the unsecured consumer loans as of September 23. Payment behavior for performing loans is different for customers with and without reschedulings. The unpaid portion for regular clients is 2.1%, while it is 14.5% for rescheduled clients for installments matured during September.

I would like to start the digital performance part of the presentation by reinforcing and highlighting that we are building 100% digital solutions for our customer journeys, which includes day-to-day banking, savings, financial planning, financing, loyalty programs, a marketplace, insurance, wealth management and acquiring for merchants through Izipay and IzipayYa, as shown on slide 17.

In the following two slides, positive news in our digital indicators, which continue to show nice trends when compared to the previous year. As of September 2023, digital customers reached 75% of retail customers who interact with the bank during the last 30 days, up 5 points in the past year. Digital sales reached 63%, up 3% from last year. And our digital self-service indicator has improved sharply from 75% to 86%. NPS has seen a deterioration for the first time in many quarters, mainly impacted by the actions related to risk profiling.

Insurance and Wealth Management digital indicators show positive developments, as well, with digital premiums still small, but reaching 10%, digital self-service reaching 57% and digital transactions for fund management reaching 43%.

Now, let's move to some more details on the performance of our four key segments on slides 21 to 30. Starting with Banking and in line with our focused strategy, we continued increasing market shares, reaching 15.2% in retail deposits as of September and 9.6% in commercial loans. However, in line with the increased riskiness of the portfolio, we have not increased further our market shares in consumer loans and retail loans. There are a couple of things that we have been working hard in the past months and that are bringing nice results, as shown in the market share increase to 14% in payroll inflows from 7% a few years ago and the 14.7% market share in sales financing, up from 10%, just 12 months ago.

On slide 22, we have seen a deceleration in top line at the bank this quarter with 9% year-over-year growth in top line with net interest income still growing double-digit, 14%, coming mainly from increased volume and yield on loans, but decreasing fees and flat other income.

There has been a moderation of yield on loans, but still 10 basis points positive in the quarter, reaching 11.6% and NIM stable at 5.6% at the bank. Risk-adjusted NIM decreased in the quarter, in line with increasing cost of risk of consumer loans.

Good news this quarter is that cost of funds moderated its growth reaching 4.2%, up only 20 basis points on a quarterly basis versus 40 basis points the quarter before. Cost of funds has been rising at market level, mainly due to two reasons: a continuous migration of retail deposits to more expensive term deposits both in soles and dollars, and the higher remuneration to commercial institutional deposits, mainly in dollars, as rates have continued to increase. Correction in the overnight deposits rate in soles continues, though at a slow pace.

Our loan-to-deposit ratio of 103% continues to be better than the industry's average and positive news is also that deposits continue to increase its share in total funding and that retail deposits market share has continued to increase.

On slide 25, moving on to our insurance business, recovery in premiums up 18% in the quarter and in market share of annuities up to 30.5%. Both individual life and retail insurance business lines, which constitute high-profitability businesses continue to grow nicely on a yearly basis, or 18% and 42%, respectively, increasing their contribution to total premiums.

On slide 26, the quarterly return on the investment portfolio came at 6%, below the extraordinary high third quarter7.9%, but on standard levels. The insurance portfolio is composed of 85% fixed income, 10% real estate and 5% equity and mutual funds, as of the end of September.

On slide 27, good news in Wealth Management is the 8% year-over-year growth in assets under management. This quarter, we saw a negative impact from investment results, but the core business continues growing.

Moving on to Payments, starting on slide 28, we wanted to give you a summary of the developments in our payment ecosystem. Growth in merchants and volumes continues with some moderation, as Luis Felipe mentioned. Izipay merchants increased 38% year-over-year, reaching 1.3 million, while transactional volumes grew 8%. E-commerce transactions are growing at the same pace and represent 17% of our total transactional volumes, as of the end of September. In the case of IzipayYa, our solution for micro merchants, growth in merchants was 42% and was very strong in transactional volumes, or 2 times, all of which are linked to an Interbank account.

On slide 29, Izipay represents a growing and profitable operation and is working on creating synergies with the bank. Revenues continued to grow 3% year-over-year, supported by the increase in transactional volumes and merchants with some pressures on margins coming from increased competition. We have seen a moderation in the transactional volumes this quarter, in line with the decrease in economic activity as market share continues to increase, reaching more than 56% in physical acquiring and almost 23% in virtual acquiring. EBITDA continues to increase on a yearly basis, but has seen a contraction in the quarterly figures, due to the impact from deferred costs from past rapid growth in merchants.

We have been working to accelerate the growth of our payment ecosystem by having all our assets work towards a common strategy. We are focusing on increasing transactional volumes, offering merchants additional services, continue to pilot low-risk loans to merchants and use Izipay as a distribution network for Interbank products, as well as a source of increased float.

We are starting to see results from this strategy as evidenced by the following four key figures: 22% yearly increase in Izipay flows coming to Interbank accounts and 31% increase in average balance on the accounts on merchants; second, two-times yearly increase in transactional volumes from micro-merchants, thanks to IzipayYa; and third, the more than 4,000 new PrestamoYa credits disbursed in our test of the new lending model to merchants.

On slide 30, PLIN has been accelerated by the new landscape of interoperable P2P system. PLIN reached 13 million users as of the end of September, with Interbank participation at 46%. The volume of transactions has continued its strong growth, reaching twice the volume registered the same quarter one year ago.

PLIN and Yape interoperability started in April, and QR code interoperability was added in September. This has been an important development for financial inclusion in the country, which the Central Bank has encouraged, and which should help to bring more Peruvians into the financial system, reducing the use of cash, which continues to be high in the country. Number of transactions has increased more than two times since interoperability started.

On slide 32, let me finalize the presentation with some key takeaways.

First, Peru's economy is decelerating, moderation of banking activity and increased consumer risk at Interbank.

Second, we are increasing market shares in Banking with moderation in consumer loans.

Third, good performance in insurance business, while investment results at Wealth Management not yet recover.

Four, tight management of costs is reflected in solid efficiency levels at the bank and IFS.

Five, digital indicators continue its positive evolution, in line with our strategy.

And last, we see clear opportunities to monetize our payment ecosystem.

Thank you very much. Now, we welcome any questions you might have.

QUESTIONS AND ANSWERS

Operator
Thank you. At this time, we will open the floor for questions. First, we will take questions from the conference call and then from the webcast.

If you would like to ask a question, please press the "*" key, followed by the number "1" on your touchtone phone. Questions will be taken in the order in which they are received. If at any time you would like to remove yourself from the question queue, just press the "*" key, then "2". Again, to ask a question, please press "*" then "1".

And for the webcast viewers, simply type your question in the box and click "Submit Questions".

And we'll pause momentarily to compile your questions.

And the first question will come from Ernesto Gabilondo with Bank of America. Please go ahead.

Ernesto Gabilondo
Thank you. Hi, good morning, Luis Felipe and Michela. Thanks for the opportunity. My first question will be related to El Niño. As you mentioned, you're increasing your cost of risk and expected losses of a moderate El Niño of around 100 basis points. But I don't know if you have explored how much of the loan portfolio of IFS could be on the zones impacted from the last El Niño experience in 2017. Just to have an idea if the provisions that you're building in this quarter will be enough and also it will be interesting if, for example, this is the peak or it will continue to have a high level of provisions during the first quarter of next year?

And then my second question is on your Wealth Management business. We have seen a lot of volatility in the valuation, in the results. So, I want to know if you have like a strategy to present more consistent results. That will be my two questions. Thank you.

Luis Felipe Castellanos
Thank you, Ernesto. First, on El Niño and the share, let me pass it on to Michela first, and then she will pass it on to Bruno for the question about Wealth Management.

Michela Casassa
Good morning, Ernesto, how are you? Related to El Niño phenomenon, we have run some numbers to estimate the percentage of the portfolio that might be impacted. Related to the retail portfolio, we are talking about something between 10% and 12%. And in Commercial Banking, the potential impacted portfolio is less than 5%.

Also, in the small business portfolio, we are expecting an impact which is closer to the percentages of retail that I just mentioned. But as that portfolio is small, it's like 700 million, 800 million soles, we do not expect a strong impact on that portfolio. So, those would be the numbers there.

As we have incorporated a moderated impact from El Niño in these forward-looking considerations, depending on how that evolves in the following months, we might need to incorporate in the fourth quarter a strong impact from El Niño, but that still needs to be seen because we have seen probabilities of El Niño phenomenon moving in different directions in the past weeks.

Bruno Ferreccio
Yes. On your second question regarding the results for Wealth Management, there are two parts to our results. First, the Wealth Management business, that has been very stable. The second part is due to the performance of the portfolio, as we've been discussing for the last six or seven quarters, and that is somewhat market-dependent. But specifically, to your question regarding our strategy to eliminate some of this volatility, the answer is yes.

We've been implementing since basically the fourth quarter of last year. We had almost 90% of results going through the profit and loss statement. We've been making a conscious effort to move all our fixed-income investments to OCI because our strategy is to collect income from the fixed-income portfolio. Unfortunately, that was being booked, again, through P&L, causing much of this volatility that you're seeing. And we have made a conscious effort to move that. We've already increased that percentage to almost 40% from 10% only at the beginning of the year.

And so, we are continuing to move in that direction. And hopefully, by the end of the year, that percentage is going to be even higher. And so long term, our strategy is, again, more fixed income, and that fixed income portfolio reflecting the variation through the OCI part of the book and not through P&L.

Ernesto Gabilondo
Thank you very much. That's super helpful. Just a last question in terms of the ROE trends. So again, this quarter and the full year will be impacted because of higher provisions, the impact on the Wealth Management business. But thinking about next year, how should we think about a trend for the ROE? Should it be feasible to be at the double digits?

Luis Felipe Castellanos
Hi, Ernesto. The short (answer) is yes, but all will depend obviously in the recovery of the economy. As you've seen, we do expect the economic growth to return to a more positive environment next year. However, that will be dependent on the extent of the impact of El Niño. And also, we also expect moderation in terms of volatility in the global market conditions. And as rates go down, probably, that will have an impact, a positive impact.

So, probably, the first half of the year will be more complicated than the second half of the year, but we do expect to slowly and surely return to an uptick in profitability. Probably next year won't be the year where we will reach our medium-term target. But depending on, again on the impact of El Niño, we will start increasing our ROE to more normal levels.

Ernesto Gabilondo
Perfect, thank you very much, Luis Felipe.

Luis Felipe Castellanos
Thank you.

Operator
Again, if you have a question, please press “*” then “1”.

And I would like to hand the call over to the InspIR Group for any webcast questions.

Valentina Porto
Thank you, Operator. The first question comes from Catalina Hevia from BCI Asset Management. The question is, “What would be the impact on the cost of risk if you adjust in your models the probability of El Niño from moderate to strong?”

Luis Felipe Castellanos
Okay. Thanks for your question, Catalina. Let me pass it on to Michela.

Michela Casassa
Good morning, Catalina. We have run some estimates already. But, of course, it will depend also on the update of the other macroeconomic variables. But what we do expect is a smaller impact of what we have already registered for a moderate impact from El Niño. So, it should be a little bit less than what we have already in this quarter.

Valentina Porto
At this time, there are no further questions. I would like to turn the call over to the operator.

Operator
Thank you. Again, if you would like to ask an audio question, please press “*” then “1”.

CONCLUSION

Operator
There appear to be no further questions at this time. I would like to turn the floor back over to Ms. Casassa for any closing remarks. Please go ahead.

Michela Casassa
Thank you, everybody, for attending our call. If you have further questions, you can always contact our Investor Relations, and we will see each other again in the next conference call. Bye, everybody.

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