

Intercorp Financial Services

2Q22 Earnings

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good morning and welcome to the Intercorp Financial Services Second Quarter 2022 Conference Call. All lines have been placed on mute to prevent any background noise. Please be advised that today's conference is being recorded. After the presentation we will open the floor for questions and at that time instructions will be given as to 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 Q&A session. Simply type your question into the box and click Submit Question.

It is now my pleasure to turn the call over to Rafael Borja of InspiR Group. Sir, you may begin.

Rafael Borja

Thank you, operator. Good morning, everyone. On today's call Intercorp Financial Services will discuss its second quarter 2022 earnings. We are very pleased to have with us Mr. Luis Felipe Castellanos, Chief Executive Officer of Intercorp Financial Services; Mrs. Michela Casassa, Chief Financial Officer of Intercorp Financial Services; Mr. Gonzalo Basadre, Chief Executive Officer of Interseguro; Mr. Bruno Ferreccio, Chief Executive Officer of Inteligo; and Mr. Carlos Tori, Executive Vice President of Payments at Intercorp Financial Services. They will be discussing the results that were distributed by the company yesterday, August 15th.

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 212-710-9686.

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 Felipe Castellanos

Thank you. Good morning and welcome to our second quarter 2022 earnings call. We appreciate you taking the time to attend this call. I want to start by thanking to all of you that participated in our first Investor Day on June the 22nd. We were very happy to share with you in detail our strategic priorities and progress including our two-tier digital strategy, the review of our main businesses, our sustainability initiatives, and the key pillars that we are executing to achieve our objectives in the short-term and the medium term, and also to achieve our purpose, which is to make sure that Peruvians achieve their dreams.

Focusing on the recent developments affecting our country, we continue to see an uncertain political environment where the confrontational relationship between the executive and legislative branches

continues. Unfortunately, we're getting used to frequent rotation of cabinet members, as well as to hear about many corruption accusations targeted to senior members of the executive branch, including the president and close members of his family and his team.

The economic front also continues to be challenging, pressured by the international environment, high inflation numbers, and a slowing economy affected by a reduction of public and private investments and reduced consumer confidence. The new economy minister has initially cut the official GDP growth forecast to 2.2% for this year, from the prevailing 3.6%. He has announced a plan to boost public investment and implement an economic reactivation plan which is expected to be announced soon.

The latest GDP growth print for June was out yesterday. The economy accelerated to grow about 3.4% for the month when compared to May's 2.3%. As a result, growth for the last 12 months now stands at 5.5% and continues its soft landing towards the range of between 2% and 3% GDP growth that most economic agents expect for the year.

Inflation rate receded a bit in July and headline inflation decreased to 8.7% from 8.8% a month earlier, but this does not prevent the Central Bank to continue hiking rates. In its meeting last week, the Central Bank increased the policy rate by 50 basis points to 6.5%. The Central Bank now expects that annual inflation to return within its target range of 1% to 3% in the second half of 2023.

Nevertheless, under this challenging scenario, IFS continue to show resilience in its core operations. However, it is important to note that the investment portfolio in our wealth management business has not been immune to the significant volatility witnessed in the global financial markets, strongly affecting our investments and overall results during this quarter. We have seen a recovery of our investments during July and August. However, we're very conscious that global financial markets remain challenging.

Our core banking franchise continues its recovery pattern with a strong growth in consumer financing and commercial banking, with increased activity and sound risk indicators.

Our insurance segment also had a good performance during the quarter as well as adequate evolution of the core activity of our wealth management franchise. As you will see later, our newly-created segment, our payments pillar, the one we're building based on Izipay and related initiatives also had good results.

Our digital traction continues to be strong, as well as our growth in total number of customers and our core revenues. We strongly believe that our culture, our people, our efficient operations, our sound capitalization, and our ability to adapt to changes through our two-tier digital strategy are our strengths, and are the pillars that will allow us to continue growing profitably in the future and in a sustainable way.

Now, I will pass on to Michela to update you on the detailed results of this quarter and give you a review of our operations. Thank you very much.

Michela Casassa

Thank you, Luis Felipe. Good morning, everybody, and welcome again to Intercorp Financial Services' second quarter 2022 earnings call. This time I will focus on two items of the agenda which include financial highlights and then our key messages and takeaways.

I will start with a brief summary of financial highlights on slides 3 to 10. The main highlights are on slides 3 and 5, IFS had strong results in banking, insurance and newly added payments, but had a negative impact from investment in wealth management. Earnings are S/ 251 million in the quarter and S/ 655 million in the first half of the year, reflecting a loss in the investment portfolio at Inteligo of S/ 147 million this quarter, and S/ 171 million in the first half of the year. This is impacting the quarterly ROE of IFS,

which stands at 11% and driving down the ROE of the first semester to 14.2%.

Banking, insurance, and payments had very strong results in the quarter with 19.4%, 31.6%, and 26.9% ROE respectively. The same is true for the first half results of the three subsidiaries with first half ROEs of 19.1% for banking, 24.6% for insurance, and 30.9% in payments.

On banking, we had a strong quarter in activity with double-digit growth in net interest income and fees and client base continues to grow almost 20% per year. The shift in loan mix and repricing of new loan disbursement has boosted NIM this quarter up to 4.9%, and in line with the portfolio mix, cost of risk has reached 1.8%.

On insurance, profits almost doubled QoQ driving ROE up to 31.6% thanks to a strong growth in interest income of 27% QoQ and 30% on a yearly basis and to a strong investment income with return on the investment portfolio of 7.7% this quarter.

On wealth management, results continue to be affected by a negative impact on the investment portfolio with a good recovery in fees of 9% quarter on quarter and a slight recovery in assets under management.

Finally, on our new payment business, we have started to show the profitability of newly acquired Izipay with a continuous strong growth in business and 27% ROE in the quarter.

Among the key performance indicators for the quarter and semester on slides number 6 and 7, I would like to highlight the strong growth in the quarterly and yearly NIM of IFS. There has been a 50 basis point improvement in the quarterly NIM of IFS driving it up to 5% and the semester to 4.7%, already above our guidance.

On slide 8, total revenues for IFS grew 3% on a quarterly basis, thanks to the growth registered in banking of 5% in the quarter, insurance with 20%, and the contribution of revenues to the consolidated figures from payments, which grew 1% on a pro forma basis and despite the negative revenues registered in wealth management. On a yearly basis, IFS registers a 3% decrease in revenues with very positive results in banking growing 13% year over year, and payments growing 33% year-over-year and decreases in insurance mainly due to the extraordinary revenues registered during the second quarter of 2021 together with the negative revenues of wealth management of this quarter.

On slide 9, the reported efficiency ratio of IFS was 40% above our 35% to 37% guidance provided at the beginning of the year, but it is 36.6%, within our guidance, when excluding the investment loss at the wealth management business. It is important to note that there is an impact in the reported figures of IFS due to the consolidation of Izipay figures starting April which reflects a higher increase in expenses this year, as they are not considered in the base of 2021. Normalizing Izipay, expenses at IFS grew 4% on a quarterly basis and 16% on a yearly basis.

At Interbank, efficiency ratio remains relatively stable year-over-year at 42.3% in the quarter, as expenses during the first half of the year have increased 14% mainly due to three reasons: a 17% increase in technology costs and new ventures which include the technology expenses for our digital transformation, as well as new investments in payments and our venture with Rappi; a 14% increase in personnel costs which is mainly coming from the increase in mandatory employee profit sharing, in line with the improvement of the local GAAP earnings; and a 24% increase in variable costs related mainly to credit cards and in line with the percentage increase in credit and debit cards turnover which generates fees and financing volumes. Other expenses have grown single-digit reflecting our continuous cost efficiency efforts. Moreover, we have continued with our branch optimization program, reaching a total reduction in the number of branches of almost 40% or more than 110 branches from the peak in 2016. Increase in

costs for the rest of the year at the bank will be lower when compared to the previous year, reflecting the base effect of the recovery of activity, which started in the third quarter of 2021.

On slide 10, we continue to have a solid capital position as evidenced by the ratios at Interbank, but also at Interseguro and Inteligo. Core Tier 1 ratio at Interbank recovered after the distribution of dividends in the first quarter and is at 11.1% as of June 2022, and total capital ratio stands at 15.2%, well above the industry average despite the strong growth registered this year.

Now, I will focus on the six key messages we would like you to take home from this call on slide number 12. First, we are operating in a very challenging macro scenario. Second, investment results recovered in insurance but are still impacted in wealth management. Third, strong quarter in our core banking business which is driving top line growth. Fourth, we continue to work on our two-tier digital strategy showing positive developments in our digital indicators to foster growth at IFS. Fifth, we are showing key initial figures on our payment business that shows strong growth. And finally, we will show you a little bit of the progress we are making in our sustainability efforts.

Moving to slide 13, we are showing the evolution of some of the key micro indicators as already mentioned by Luis Felipe. The exchange rate has registered ups and downs in the past weeks reaching S/ 3.83 per dollar. Inflation has picked up to 8.7% as of July, in line with high levels of inflation in other countries. And interest rates have continued to increase, as evidenced by last week's extra increase of 50 basis points of the Central Bank's reference rate, which stands now at 6.5% as well as increases in the dollar rate, which stands now at 2.5%. We have seen a reduction of the extra soles liquidity that was present in the Peruvian market in the past month up to July, but we are also starting to see the positive liquidity impact of the flows coming especially from the private pension funds.

On slides 15 and 16, we are showing first good news with the recovery of the return of the investment portfolio of insurance which reached 7.7% in the quarter and was 6.4% in the semester, more in line with past average performances. On the wealth management front, we have continued to see a strong negative impact of mark to market on the investment portfolio during this quarter, which adds up to the performance of the previous quarter and remains in negative territory, strongly impacting the first half results of Inteligo so far. As Luis Felipe mentioned, we have seen some first positive developments during July and August, but cannot yet confirm a positive trend for year-end, as these will depend on the continuous recovery of the markets.

On slide 18, moving to the good news on banking, we have continued to see a solid performance in activity in the quarter, yet some signs of slowing down in financing, as we have started to adjust our credit underwriting standards in specific sub-pockets of low-income clients, which start to see some impacts of the slowdown of the economy and sustained inflation.

Credit cards and debit cards turnover have increased substantially year over year or 65% for credit cards and 38% for debit cards. Despite the slowdown in the economy, we continue to see important growth in turnovers as both credit and debit cards continue in their path of increased penetration in the country, which continues to be low. This growth has allowed us to increase market share almost 150 basis points in the past 12 months for the combined turnover, thanks mainly to our Interbank benefit program, our increased focus on e-commerce in high growth product categories, and finally, also thanks to our upselling strategy. Moreover, credit card sales have increased 50% year-over-year close to 2019 levels.

New disbursement of personal loans has seen a slowdown when compared to the previous quarter but are 44% above the same quarter of last year. As of the end of June, credit cards and personal loans were up 46% when compared to last year and are up 21% when compared to 2019.

On the SME front, we have continued to see strong disbursement in the second quarter which are 72% above the level of last year and are helping this portfolio to grow nicely during this year.

On slide 19, one of the very good news in this quarter is the sustained double-digit growth in net interest income and fee income. Net interest income at the bank grew 18% with a strong contribution net interest income coming from credit cards and personal loans. Fee income grew 17%, thanks to the strong growth of credit cards fee income due to the strong evolution of credit and debit cards turnover, but also to the sustained strong growth in fee income coming from cash management services in commercial banking. Other income at the bank was down 14% year over year, slowly recovering. All-in-all total core revenues grew 13% year over year, a very strong recovery in banking revenues which continues with a positive operating leverage.

On slide 20, we have seen a strong portfolio shift to higher yielding loans in the past 12 months. Retail loans reached 52% of the total portfolio versus 46% one year ago. Moreover, credit cards and personal loans reached 21% of the total loan book versus 15% one year ago. This effect together with the increase in the SME loan book, still small, and the increase in rates is pushing yields on loans upwards 80 basis points in the quarter and 140 basis points in the year reaching 9.1% and NIM 40 basis points up in the quarter and 100 basis points in the year reaching 4.9% for Interbank. Risk-adjusted NIM has improved 10 basis points in the quarter and 90 basis points year over year up to 3.7%. We expect the positive trend in NIM to continue in the coming quarters, though at a more moderate pace.

We have also seen rising cost of funds as we start to see the effects of the rising rates of dollar funds on top of the already existing and newly increases in soles rate, as shown on slide 21. Cost of funds reached 2.2 in the quarter, up 40 basis points on a quarterly basis and 80 basis points on a yearly basis, still lower increases when compared to yield on loans. We continue to have the best LDR among peers at 101% as of June 2022, levels more aligned to pre-COVID. The system as a whole has seen a reduction in the extra liquidity that was present in the market in the past month due to the many government measures and has returned to pre-COVID levels at around 108%.

On slide 22, we have a healthy risk profile with increasing levels of cost of risk in line with the shift in loan mix. Cost of risk in the quarter was 1.8% getting closer to pre-COVID levels of around 2%, mainly due to the recovery in the retail portfolio, which has reached a cost of risk of 3.6% close to the 4% pre-COVID. The NPL coverage ratio of Stage 3 loans at 186% is still above pre-COVID levels of 158% and this is mainly related to the coverage ratio of the retail loans, which stands at almost 250% well above the 179% pre-COVID.

Now, let's move to the fourth key message on slide 24 of this presentation related to the positive development in our digital indicators. We continue to see strong progress in our digital indicators. As of June 2022, digital customers reached 68% of our customers who interact with the bank during the last 30 days, up 5 points in the past year. Digital acquisition reached 56%, up 13 points from last year and digital sales reached 67% in June, increasing 9 points in the last year. We have continued to see an important number of new digital accounts being opened for both individual and businesses. As of the end of June, 66% of new retail savings accounts were opened digitally, while 92% of new business accounts were opened digitally, up 8 points and 12 points respectively. NPS for digital customers continues its path to become a top NPS in the next years reaching 47 points this quarter, up 7 points in the last year. Insurance digital indicators show positive developments as well, with SOAT insurance at 80% and Vida cash life premiums, a digital product, reaching 34% of total life premiums.

On slide 26, we continue to see an important growth in our customer base of around 20% in both retail and commercial banking customers, reaching five million as of the end of June. Starting this quarter and following what we already introduced to you during our first Investor Day on June 22 this year, we are

starting to show separate information on our fourth business segment, payments, which for the time being includes information related to Izipay and which will in time start to add up the info related to the complete payment ecosystem. The information reported this quarter is still preliminary as we are in the process of determining the fair value of the acquired assets and liabilities, as well as the intangibles which we'll be reporting during next quarter within the payment segment.

After the acquisition of the remaining 50% of Izipay and the creation of the segment, Carlos Tori has been appointed as EVP of Payments at IFS, formerly EVP of Retail Banking. Within the bank, César Andrade, formerly EVP of Operations and Technology, has been appointed the new EVP of Retail; and Alfonso Díaz, former EVP of Digital Delivery, is the new EVP of Operations and Technology.

On slide 29, let me start reminding you the three main lines of business of Izipay. First, acquiring business where Izipay is the card present market leader and a strong competitor in e-commerce acquisition, accepting all different cards and payment platforms including Visa, MasterCard, Amex, Diners, Apple Pay, PLIN, Tunki, and Yape among others, in which fee income represents around 89% of the total fee income as of the end of June. Correspondent banking, which represents 7% of total fee income and credit card processor, which represents 4% of total fee income.

On slide 30, as we explained to you on our previous meeting, Izipay is a company that has been growing substantially in the past years, especially in the past month, as evidenced by the 53% growth in the number of merchants and 66% growth in the number of transactions in the past year. Moreover, it has monetized this growth as evidenced by the 33% growth in revenues in the past year, reaching S/ 81 million in the quarter. It is important to notice that there is still a big space for further growth given the low penetration of digital transactions in the country.

Finally, on this section related to payments, we wanted to show you how the growth of PLIN and Tunki has accelerated this year, reaching eight million users for PLIN and two million in Tunki, but especially how both payment platforms are picking up in number of merchants with two and three times the numbers registered last year, respectively, and even more in number of transactions with three and four times the numbers registered last year. Moreover, we have seen a strong growth of more than 20% in the single month of July in the number of transactions.

In the short term, we are working on growing each initiative both independently and creating the synergies to accelerate the growth of our payments ecosystem by having our assets work towards a common strategy. We will focus on increasing transaction volumes, offering merchants additional services, such as electronic bills, inventory management, and cash advances, continue to pilot loans to merchants, and use Izipay as a distribution network for Interbank products as well as a source of float.

Moving to slide 33 regarding our sustainability strategy, we continue to build upon our four focus areas. Inteligo finalized its first carbon footprint measurement, while Interbank and Interseguro obtained a third-party certification of their measurement results. Working towards our goal of promoting financial inclusion for all Peruvians, our digital financial education platform, Aprendemas, exceeded expectations in its first three months since its launch at the end of April.

At a national and regional level, we received several new recognitions for our culture and talent management. And furthering our commitment to comply with the highest international standards Interbank is now signatory of the UN Global Compact, and we have kicked off our first-ever platform-wide materiality assessment for IFS.

Finally, we have launched an e-learning sustainability course for employees at all levels across all businesses to strengthen our sustainability culture.

Before ending the presentation, let me now move to the comparison with guidance for this first half of the year. Capital ratios to remain at sound levels with total capital ratio above 15% and core equity one ratio above 11%. First half total capital ratio stands at 15.2% and core equity Tier 1 ratio at 11.1%. This is in line with guidance.

Second, a continued path to recovery in core profitability with IFS ROE above 16%. The first half ROE was 14.2%, below our guidance, mainly due to the negative impact on the investment portfolio at Inteligo as ROE for banking, insurance, and payments were strong in the first half of the year. Year-end ROE will depend on the recovery of the investment portfolio, as we expect banking, insurance, and payments to continue to perform well throughout the year.

Third, high single-digit growth in total loans led by double-digit growth in consumer loans together with the substitution of a portion of Reactiva loans in commercial banking. As of June, total loans grew 14%, above guidance, and consumer loans are growing more than 20%. But we expect growth to moderate in the second half of the year and to be in line with guidance.

Revenues, we continue to recover with a NIM expected between 4.2% and 4.6%. The recovery of NIM is taking place a little faster than we expected with first half NIM already at 4.7%, which indicates that we will most likely end up the year with NIM above guidance.

Cost of risk to be around 1.8%. First half cost of risk is at 1.6% with the second quarter cost of risk at 1.8%. We expect to be in line or close to guidance.

Finally, we will continue with our focus on efficiency, and we expect the efficiency ratio to be between 35% and 37%. The first half efficiency ratio at 38.7% is above guidance only due to the negative impact on revenue from the investment portfolio of the wealth management business. Excluding such effect, the efficiency ratio would be 36.9%, within our guidance.

On slide 34, let me recap the six key messages of this presentation. First, we are operating in a very challenging macro scenario. Second, investment results have recovered in insurance, but are still impacted in wealth management. Third, we had a strong quarter in our core banking business, and this is driving top line growth. Fourth, we continue to work on our two-tier digital strategy, showing positive developments in our digital indicators to foster growth at IFS. Fifth, the key initial figures on our payment business are promising and show strong growth. Finally, we continue making progress in our sustainability efforts.

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

QUESTIONS AND ANSWERS

Operator

Thank you. And at this time, we will open the floor for your questions. First, we will take the questions from the conference call and then the webcast questions. If you would like to ask a question, please press star then one on your touchtone phone. Questions will be taken in the order that they are received and if at any time you would like to remove yourself from the questioning queue, just press star then two. Again, that is star then one to ask a question. For those on the webcast, you may just simply type your question in the box and click Submit Question. We will pause momentarily to compile the list of questioners.

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

Ernesto Gabilondo

Hi, good morning, Luis Felipe, Michela, and good morning to all your team. Thank you for your presentation. I have three questions from my side. The first one is on the wealth management business. Can you elaborate what was behind the loss? Was it related to fixed income positions or equities? And also, if you can provide which sectors and what would be the strategies that you will be implementing to have more stable numbers and to avoid too much volatility in the results, especially as the rest of the subsidiaries have ROEs above 19% and this is clearly the one affecting the consolidated number?

Then my second question is on asset quality. We noticed that your Stage 3 portfolio showed the lower NPL ratio for the quarter. However, when looking to Stage 2 and 3 was increased due to the low mix. So how should we think about the NPL in the next quarters? And when do you see them returning to the pre-pandemic levels?

And then, lastly, is a question on your digital channels. If you can provide us some color on what is the level of profitability that you currently have at Izipay, PLIN and Tunki and when do you expect them to become profitable, if that is not the case? Thank you.

Luis Felipe Castellanos

Okay, Ernesto, thanks very much for your questions. Let me give you a background answer and then pass it on to each of the members.

On the wealth management, on the investments, obviously what has happened there as mentioned during my introduction, it's very much market related. Now, we've seen what has happened in the market during these three months, especially May and June, have been very volatile. And, again, our portfolio which is a mix, and maybe we can get a little bit more detail later is of some equity and fixed income, but even the fixed income indexes have come down significantly given what's happening in inflation.

So, we track our investments against certain benchmarks and although we have over-performed our benchmarks, the results overall have been impacted. And if you remember, profitability for Inteligo year-in year-out have been around 25% ROE. So, this year is a particular one because of international market conditions. And obviously, again, it has not been immune to those trends.

We are very confident on the investments we have. They are related to financial services, technology, very close to obviously what we do because the vision there is twofold. First, we do believe medium term and long-term, they are good investment, and we like the industry dynamics, but also, it allows us to have a foothold in order to be close to companies where we can learn about their operations in their own jurisdictions. And that brings an edge to our management teams in order to be close, in certain instances, by just following the companies or even having access to management and participating more actively in the understanding of their strategy, technology, and developments. So, basically, that's the overall concept.

So, hopefully, volatility will go down once the markets get a little bit more stable. We do see Inteligo returning medium, long-term to the levels of profitability that we have been seeing, again, because we think those are sound names or sectors where we are looking at.

The particularities, maybe I don't know if, Bruno, you can elaborate a little bit more.

Bruno Ferreccio

Yes, I think you answered pretty much everything. But on the first part of what type of asset class has contributed to the mark to market losses, like Luis Felipe was saying, it's both equity and fixed income. Basically, everything was down for the first six months in the market. So, those mark to market losses

have affected the portfolio.

The other thing I wanted to mention is we have about 80% of the results in our portfolio go through P&L and only 20% through other comprehensive income. So, what we're seeing here is most of the impact is going through our P&L. And that's why it seems a little bit large, but I think it's the way the accounting mandates and I think it's a little more transparent also, because we are taking most of our results, again, through P&L in a quarterly basis.

So, I think that's it, Luis Felipe.

Luis Felipe Castellanos

Yes, basically what you see there is what you get. Now on the second part, the asset quality, yes, I think, Ernesto, Michela mentioned there's a couple things. First, there's a change in the asset mix; we're getting heavier than previously, basically, returning to our previous levels, pre-pandemic, of consumer loans and credit cards. And there also we've been seeing, given the high inflation levels, a deterioration of the portfolio itself.

And as Michela mentioned, we are already, we have been already taking measures for the last three or four months actually in order to cut a little bit or improve our underwriting standards in certain segments. So, hopefully, we will return to lower numbers I would say by year-end or early next year, but maybe Michela can help us a little bit more on this part as well.

Michela Casassa

Yes. Good morning, Ernesto. As I showed in the slide, cost of risk for this quarter was up to 1.8%, still slightly below pre-COVID levels. And this is being driven as Luis Felipe is mentioning due to the portfolio mix and the recovery in the balances of especially credit cards, but also personal loans. Now, the cost of risk of total retail is at 3.6%, now close to the 4% of pre-COVID. I mean actually what I think is going to happen is that we will be close to these levels now as of the end of the year. But we do see credit card, especially, already very close to pre-COVID levels. So, even if still not due to the portfolio mix now we have also a little bit more mortgages than before, etc., the overall cost of risk is still below pre-COVID levels. It is really, really getting close to it especially within the consumer loan book. So, most likely during next year, we will already see all the effects of this new portfolio and levels we will be maybe even slightly above the pre-COVID of 2.2%.

Luis Felipe Castellanos

Okay, and then the third part, the digital channels, let's see this. Izipay is already a profitable company. And again, we're taking a cut and showing the numbers. As you know 50% of Izipay always went through Interbank's financials and now that we acquired the other 50%, we have been able to isolate that to try to illuminate a little bit more the value of that platform or franchise. As Michela mentioned, this is still preliminary because we're still doing the accounting work. However, we do expect that for next quarter, we'll have the complete view of the fair value of the assets, the accounting treatment and goodwill or whatever gets created there. That's on the works. So, we'll be updating on the numbers.

On the other solutions, again, PLIN, just to remember when we explained this vastly in our Investor Day is basically a network that is facilitating P2P and P2M transfers for our customers. So, it is that, a network. And Tunki, it is a digital wallet itself and we have some numbers there that are very interesting in terms of acquisition costs and operating costs much lower obviously than the traditional channels.

I don't know, Carlos, you if you can give us some light on those type of numbers, so we can put some guidance on this.

Carlos Tori

So, as you mentioned, first going to Izipay, it is profitable. Like income before taxes for the first half has been S/ 45 million for this half, and after taxes has been S/ 28 million. EBITDA is strong and we continue to grow in that business, so that is good and healthy. As mentioned by Michela, we expect to continue to grow in Izipay. So, that's solid.

In terms of Tunki, it's probably the lowest acquisition cost we have at IFS. We continue to grow. We've grown almost probably around 8% or 9% per month in the last quarter. So, we grow.

In terms of income, it's still not profitable. But the expense is very low. It's very organic. And so we're trying to put together statements for the whole payments vertical and we'll try to show that in the future. But right now, we're focused in continue to grow Tunki and its income and obviously the number of merchants and transactions.

Luis Felipe Castellanos

Okay, thank you, Carlos.

Ernesto Gabilondo

It was super helpful. Thank you so much.

Luis Felipe Castellanos

Thank you, Ernesto.

Operator

And our next question will come from Juan Recalde with Scotiabank. Please go ahead.

Juan Recalde

Hi, thank you for taking my question. I had a follow-up on the payments business. So, I think I want to know more about the profitability and growth expectations. So, in particular, you showed that I think Izipay had around 27% ROE in the first half of last year, 31% ROE in the first half of this year. So, how should we think about the sustainable or long-term ROE for this part of the business? And in terms of growth expectations, what are your growth expectations for this business?

Luis Felipe Castellanos

Okay. Hi. Thank you very much for your questions. Let me take a crack at it and then I'll pass it on to Carlos. But again, I want to reiterate that again, we had 50%, so 50% of the numbers of Izipay were already at Interbank. So, what we've done we've taken them out and add the performance of the other 50%. We're still working on the final accounting of that. Once we have the complete accounting numbers, we will be able to have a more specific number for the overall transaction after purchase. But yes, it's a very profitable operation. It continues to grow because the opportunities are very big.

I think we're not ready to provide guidance at this stage. Because again, this is a very new acquisition. However, the prospects are very positive. We still continue to think that growth is going to be very important. And obviously, probably with the new strategy, we will accelerate investment levels. But as soon as we go deep into that, we will be able to share it with you and the market. So far, this is still work in progress.

Let me pass it on to Carlos to see if there are anything I missed. But again, guidance on Izipay is still something that we are not ready to share.

Carlos Tori

Yes, I agree, Luis Felipe, just to make it clear on the accounting numbers what may change because of the goodwill is how you calculate the ROE or the equity within IFS, but the income is there, and it won't change. So, that's something that's good.

In terms of growth, obviously, we cannot give specific guidance. We've been growing in the past couple of quarters. We've been gaining share in physical POS. We reached we believe around 50% coming from 15% four years ago. So, we reached 50% in the last few months. We expect to continue growing that, but probably not so much market share, but the market continues to grow. There's more payments. So, probably the number of growth in merchants might slow down but we see more payments every month as people are changing their habits.

The additional opportunity for growth is e-commerce. We continue to grow. As we showed in the presentation right now, e-commerce represents 16% of the fees that we charge. We expect to grow that. It has been growing from 12% to 15% to 16%. So, that's another avenue of growth. And then we will look for avenues of additional income, as Michela mentioned, aggregated services, cash advance and stuff like that, that should come in the next few quarters. As we develop, we try it and start to penetrate our customers. We have 800,000 merchants. So, it's a lot of opportunity for additional services and processes.

So, that's kind of the plan. No specific guidance but those are the avenues of growth for the next couple of quarters.

Luis Felipe Castellanos

Still lots of work to be done in order to make sure that we take advantage of those opportunities.

Carlos Tori

Yes.

Juan Recalde

Thank you. That's helpful and one more question if I may. This one is related to the consumer loans. So, I saw that the payroll loans are growing at a slower pace versus credit cards and other type of consumer loans. So, I was wondering if you can comment on what's driving these differences and whether you expect this to continue being the case.

Luis Felipe Castellanos

Sure, yes. I think what is driving this is, first, it's our discipline on rates, basically. That's the main explanation. We've seen competitors do some crazy things in that market. And again, we're very disciplined in pricing with cost of funds going up and certain deterioration of the overall economy. We're very disciplined. I'm sure we're very focused on sustainable growth. And I think that some rates that we're seeing in the market are not ones that we're ready to be very aggressive. So, probably that's going to continue for some months ahead. And once the specific costs of funding go through the P&L of competitors probably that is going to decelerate a little bit their aggressiveness as well. That is very much market related and appetite about profitability for us in that business.

I don't know, Michela or Carlos, if you want to add something to it.

Michela Casassa

No, I think it's that. I mean, we've been very disciplined in the payroll loans which is the one that is growing slower, because I mean, we are market leaders there. And also, basically we are like trying not to contaminate if you want the overall rates. Now, in a market of growing rates, we've been seeing a

decrease in rates on new disbursement from competitors. So that was the reason why we have tried to be as much conservative as possible and try to preserve the profitability of that business.

Juan Recalde

That's very helpful. Thank you for the comments.

Luis Felipe Castellanos

You're welcome.

Operator

And our next question will come from Jorge Henderson with Santander. Please go ahead.

Jorge Henderson

Hi, thanks for the Q&A space and the presentation. I have two questions. I'd like to understand your expectations on risk adjusted NIM for the rest of the year. Do you see upside for your first half 4% level? Or do you expect a more balanced mix of higher cost of risk and net interest margin maintaining risk adjusted NIM at current levels?

Also, I wanted to ask you about the effective tax rate. What's the reason behind the higher than 30% effective tax rate on this quarter? And also, what is the effective tax rate that is implied for your guidance of the year of above 16% ROE? Thanks.

Luis Felipe Castellanos

Okay. Number one, I'm going to pass it straight to Michela. Number two, I'm going to venture to answer it and maybe Michela can correct me or complement it. But I think particularly this quarter, the high effective tax rate is related to the Inteligo results, basically, because it's a loss that normally it's tax exempt.

So, probably that's hitting it, but Michela will be able again to answer number one and correct me on number two.

Michela Casassa

Yes. On tax rate, you are right, just adding up that also there is a slightly higher rate on Interbank. I mean, the taxes are calculated on local accounting and the tax base has been a little bit higher in the local accounting standards. That's also to add to the tax rate.

On the first question related to the expectation of risk adjusted NIM, I mean, we expect NIM, first of all, to continue to improve throughout the year, though, at a more moderate pace. You've seen at the bank, we've had 40 basis points improvement in NIM in one quarter. We don't expect to see that in the rest of the year, but it should continue to slightly recover.

But also cost of risk is kind of slightly moving upward due to mix. So, most likely, when we put the two things together, the risk adjusted NIM, I mean, either is going to be stable most likely. I don't see it going upward any further because of the two opposite effects driving it.

And I think the last question was related to the ROE guidance for year-end. Right?

Luis Felipe Castellanos

The implied tax rate for the ROE guidance.

Jorge Henderson

The guidance was given on the last quarter or from the first quarter I think. So, I mean we have more information, but I just wanted to understand not the implied tax rate maybe but more what do you expect going forward? if you expect the effective tax rate to be around 29% rate or higher, lower.

Michela Casassa

I mean, on the effective tax rate, to be sincere, it will all depend on the impacts of the investment portfolio. I mean with normal conditions it should be around the levels that we have seen in the past year so below that 29% but we need to check with the investment portfolio. Because I mean, normally we see numbers more close to 25%, 27% effective tax rate. So, if we have positive results in Inteligo, we should see numbers normalizing to those levels.

And related to ROE, as I previously mentioned, I mean banking, insurance, and payments have shown strong ROEs in the first half and we expect that to continue to happen in the rest of the year. The question mark is the recovery of the investment portfolio and how it all adapts to the IFS ROE.

Jorge Henderson

Okay, great. Very good. Thank you very much for the color.

Michela Casassa

No, thank you for the question.

Operator

And our next question will come from Daniel Mora with Credicorp Capital. Please go ahead.

Daniel Mora

Hi, good morning, Luis Felipe, Michela, and thank you so much for the presentation. I have a couple of questions. The first one is regarding the loan growth. Even though you mentioned that you expect a single-digit loan growth in 2022, what could be the expectations going forward considering the high inflation, the higher interest rates, the economic deceleration? Do you feel that you're going to see like a strong deceleration, for example, in consumer demand given the challenging macro scenario?

And considering this scenario, my second question is regarding to NIM in the coming quarters. Considering also the loan growth and the performance of the higher interest rates, when do you feel that we can see the peak of the NIM and what should be like the normal figure of NIM in the long term for the company? Thank you so much.

Luis Felipe Castellanos

Okay, let me pass it on to Michela to elaborate on those questions. Thanks a lot.

Michela Casassa

Okay, good morning, Daniel. Thanks for your questions. I mean, related to loan growth, as you have seen the total loan growth excluding Reactiva has been very high. As of June, it's 14% but we are guiding to go back to single-digit levels for year-end.

What we have seen already starting July is lower growth in consumer financing. So, that part if you want is already there and we have also seen a little bit of slower growth in mortgages hand-in-hand with the increase in rates that has been very strong now in terms of new disbursements.

Commercial banking, though, has seen a strong second quarter, first because SME's recovery, but also because we were very cautious in terms of rates in the first quarter. And then once—most of the

increasing rates are already there in the market, we have started to lend short-term working capital loans to large and medium-sized corporates. Now, for sure investment from companies, I mean, are not there due to the situation. So, commercial banking will slightly decelerate, but there is a positive effect there related to the repayments of Reactiva. So, basically companies are replacing all Reactiva loans with traditional loans and that is helping commercial loans to continue to grow even if investments are not there.

So, all-in-all, for year-end single-digit still, retail, especially consumer, will continue to be double-digit and most likely I mean, we are not giving guidance yet for 2023, but most likely we will see I mean lower levels of growth next year when compared to this year, when there was also still kind of a recovery effect or base effect from COVID levels.

And taking this to NIM, I mean, yield on loans especially will continue to go up I mean for some quarters. I don't have all the quarters of 2023. But it will continue to go up because first, the portfolio mix has already changed and that has a full-year effect in the numbers in the coming NIM. But also the increase in rates has been steep and gradual and we've had new increases of rates even in July and August. So, basically the yield will continue to increase. So, all this creates a positive effect in yield on loans which will drive NIM up even if we are also seeing a faster increase in cost of funds because of the hiking in rates.

But all-in-all, we will see yield on loans still increasing in the coming quarters and that should drive also NIM upwards during the rest of the year and a part of 2023.

Daniel Mora

Perfect. Thank you so much for the answers.

Michela Casassa

Thank you.

Operator

And our next question will come from Yuri Fernandes with JPMorgan. Please go ahead.

Yuri Fernandes

Thanks, everyone. I had just a question regarding equity growth like your OCI impact. I guess Inteligo had some hits and you mentioned during the call that part of the losses they were to P&L and part on the equity side. But when we look to the bank and the insurance company, we also had some OCI hits. So, my question is, what should we expect to hear for the coming quarters? I guess, the ten-year in Peru, it's more stable now. So, maybe is the worst behind for OCI? And how does OCI affect your capital ratios? Because we don't see a lot of things on your Tier 1 ratio, but just checking how OCI losses could impact you there. Thank you.

Luis Felipe Castellanos

Thank you, Yuri. Let's see, I think you're right. Some of our portfolio, especially probably at the insurance company at the bank, you're right. Because again, in Inteligo, mostly everything goes through P&L. So obviously, for the bank, like Interbank and Interseguro, the fixed income portfolio, basically, that's all fixed income, at least in the Interbank level that's hitting OCI.

I agree with you probably the worst is what we're seeing now or actually, it has improved recently, but what we have seen by the end of June, maybe at the beginning of July. So, we do expect some upside on that front. However, again, we have to closely follow market evolution. We're very well-capitalized. It's having its toll, but it's not affected significantly. Depending on the month of the year, especially, I think,

for year-end, we won't see significant changes. Probably early next year, we'll see something.

But maybe I can pass it on to Michela to elaborate a little bit more on this.

Michela Casassa

Yes. Thank you, Luis Felipe. Yuri, actually, we do have already an impact in the ratio, especially at the bank level. So, the unrealized losses, the ones that go through the OCI at the bank, because of the increase in rates and the impact on the sovereign bond portfolio we already have an impact in the ratios that you see. So, basically, the total capital ratio that we show, the numbers that we have shared, and also the core equity Tier 1 already are reflecting a negative impact of this. So, basically, what I'm trying to say is that the 15.2% total capital ratio and the 11.1% capital ratio actually would be much higher if the negative impact on unrealized gains was not there in the portfolio. And we're talking of numbers that could be even like 50 basis points above the ones that we are showing. So, actually, I mean, there is upside potential, there for the ratios.

But let me also mention that as Luis Felipe was pointing out, there is a seasonal effect with these impacts, especially in the first half of the year because those results are offset by the retained earnings that you have. So, basically, what happens is that at the beginning of the year what you do not have—I mean, after you have capitalized and also distributed dividends, you see the negative impact altogether, and then once the retained earnings continue to build up throughout the year those impacts reverse in the second, third and fourth quarter of the year.

So, that was also one of the reasons why the core equity Tier 1 ratio in the first quarter was slightly below 11%, 10.9%, because we had the two impacts together, the distribution of dividends, but also a negative impact from the unrealized gains in equity. I don't know if that's clear.

Yuri Fernandes

No, it does. Thank you, Luis Felipe and Michela. I guess that was my point, if you have some kind of upside on your capital and hopefully rates become more stable in Peru. Thank you very much.

Luis Felipe Castellanos

I think I'll give one more thing, just in terms of that portfolio. That's basically soberanos and global related to like global bonds, like Peru risk, and short-term, no long-term dated. So, another effect is given their long tenure once we go through like that time effect on that portfolio should also help and bring an important tool towards diminishing those numbers as well.

Yuri Fernandes

Perfect. Thank you.

Michela Casassa

Yuri, let me add one thing, sorry, just not to leave the impression that we will have the capital ratios super higher than what we're showing, is that starting January, we will be implementing some changes in the definitions that the superintendency has already disclosed, but it's kind of, I mean, regulating into the details.

And there are a couple of things that we are still evaluating or things that first were risk weighted asset that now could go directly to deduction of equity. That could have some impact in the ratios. So, once we have that sorted out, because we are in the face of giving comments to the superintendency, we could give you a little bit more light on that.

Yuri Fernandes

So just to make clear, Michela, on this part, like bottom line is that maybe the risk density may increase a little bit in Peru. Is that right? So basically, you can have some—

Michela Casassa

No, no. Not increases in risk weighted assets. No, there are a couple of things that were before in risk weighted assets that could go to be deductions directly from equity. So, basically, it's a different impact. It's bigger the impact when you deduct directly from equity versus when you have them in risk weighted assets.

Yuri Fernandes

Got it. So, basically like we have these in some countries, like VTAs you were using like some kind of risk factor on your RWA and now you kind of deduct directly from the capital. And because you have that base effect, you can have some effects on the ratios, if assets as RWA and some things like equity deduction.

Michela Casassa

Yes, it's not—I mean, it's not big numbers we're talking about but there are some things that may impact, so that's why I wanted to make it clear.

Yuri Fernandes

Okay. No, it's very clear. My point was like should we see OCI improving from now on and if there is any kind of impact, and you were very clear on your answers. So, thank you very much.

Luis Felipe Castellanos

If you tell us where the market is going, Yuri, we will tell you what is going to happen next.

Yuri Fernandes

I wish I knew. Thank you, guys.

Luis Felipe Castellanos

Thank you.

Operator

This will conclude the audio questions. I'd like to turn the conference over to Rafael to read any webcast questions. Rafael?

Rafael Borja

Thank you, operator. So, we have some questions via chat. The first one is coming from Greg Mitchell. "Can you please discuss the challenges and opportunities for attracting and retaining talent, especially at the highest levels of the company and in the digital strategy?"

Luis Felipe Castellanos

Sure. Thank you. Hi, Greg. Great question. Obviously, one of the biggest challenges that we are facing strategically and in terms of building what we want to build is talent, not only for digital, but also for analytics and all the new skills that are required for the transformation of a company like ours and being able to compete in the current environment. However, I do feel comfortable that even though it's a challenge, we're taking the right steps. Our team has been reinforced in the recent years with many talents and we're exploring different avenues. And actually, what we've seen through the pandemic and the way we have changed in terms of how we're working now with our newly deployed Interbank ERES way of working, which is pretty much remote first and hybrid is also helping us. Okay?

So, first, obviously, we have a specific HR team targeting, attracting, monitoring, developing and retaining that talent. So, we have a specific team targeted towards digital and analytical talent. So, we're very focused on that. Then our way of working helps us very much because this talent is looking for flexibility, but not also that, it also helped us to expand the way we're looking for talent. So, today, we have a setup where we have people working from Argentina, specifically, for analytics, from Colombia, our cybersecurity team is based from there, from Chile. So, Peru is no longer the bottleneck because of that, and we are pursuing that strongly.

And then we are making sure that we have the right projects because as you know, this is all project-based. And we think that the type of projects that we are developing in terms of analytical things that we're doing, and digital solutions that we're bringing to market and the way we are rebuilding the bank and the way we we're approaching our two-tier digital, with transformation by one side and looking for new avenues of growth, is providing us with projects that people of this type of skills are really being attracted to.

I mean, when you complement these to what we have built with Labentana, which is our innovation lab, and the types of support that we're getting from them, and also La Victoria Lab, which is the industry-wide innovation group, we just had a great event yesterday about internal entrepreneurship where we have more than 20 projects from the group and more than seven from IFS that are going through an incubation process. So, we're doing very different things in order to make sure that those talent feel challenged and motivated.

And lastly, we continue to focus on our culture. Interbank is for instance Number One Place to Work For according to the Great Place to Work. Number one, by Merco. We have recently been named number three in Latin America. So, that also helps us very much according to a Great Place to Work. Similar to Interseguro, similar to Izipay, similar to Inteligo. They've been ranked top in culture and climate in the region and in Peru. So, we think we have all the elements to make sure we continue to attract those type of talents.

But definitely one of the biggest challenges that every company is facing today is talent. And the way to tackle that is to go beyond what we can find to improve. I hope this answered your question.

Rafael Borja

We have another question from Parag Jariwala from White Oak Capital. "What is the split between equity and debt of the losses in wealth management business? Are there any further losses in wealth management that have accrued and shall come through in upcoming quarters?"

Luis Felipe Castellanos

Okay. Thanks very much for that question. Let me pass it on to Bruno so he can maybe give us a little bit more of a specific. I think we talked plenty about this. But anyhow, Bruno, do you have anything to add?

Bruno Ferreccio

Yes. So, approximately I would say 40% of the mark to market is due to fixed income and 60% due to equity. So that will answer the first part of the question.

With regards to what do we expect, I think it's early to tell. Certainly, the second quarter, the markets have been behaving better so that should bode well for the portfolio. But we're only 45 days into the quarter and there's a lot still to come for the second half of the year. But certainly, if the market behaves better, our portfolio should do the same. And again, like I said, most of the results from the portfolio are

going through P&L. So, we should see that impact for the third quarter and the second half of the year.

Rafael Borja

We have another question from Daniel Merida from Diviso Bolsa, it's regarding capital allocation. "Could you consider a share buyback program as a way to create value for shareholders considering that you are having some good results and expect to reach an ROE over 16% but the company nowadays is only being valued at around 1.2x book value?"

Michela Casassa

Yes, let me take that question, Luis Felipe. He's there, but let me just take it, Luis Felipe. The question is related to share buyback opportunities given our more than 16% ROE and the low valuation.

Luis Felipe Castellanos

Yes. Sorry, I just dropped for a moment, but I can take it. So, thanks very much for the question. We're always evaluating alternatives. Right now, we don't have that in plans. So, we will continue to monitor both capital requirements, performance, our prospects, own liquidity, and the vehicles where we can do this. But so far, although we do think there is an opportunity on that front, we have not yet proposed anything or taken that decision. It's obviously always on the table and being evaluated. But we also look at the liquidity of the stock. So, again, we did our IPO in 2019 in order to boost liquidity and enable it to have more showing and trading. So, those are like balances that we need to take into account before actually taking a decision.

But we'll make sure every possible avenue through operations or through any of a different alternative is taken into account in order to make sure that once the volatility and the dust settles on the international conditions and the local conditions, we can get back to where we think the value of our franchise should be.

Rafael Borja

We have one more question from Tejkiran Magesh from White Oak Capital. "The commercial loans have contracted year-over-year with increasing commodity prices. It would seem that the demand for working capital loans will increase, but it does not seem to be the case. So, could you comment on the demand outlook and your approach to commercial and working capital loans?"

Luis Felipe Castellanos

Yes, obviously, again, the economic prospects for the country are not very positive. We see that there's a deceleration of the GDP; both consumer confidence and the business environment overall, private investment and public investment are not picking up. So, we do see a second semester of the year where demand for new loans or new projects is not there.

However, there are always opportunities. If we take out the Reactiva part of it, probably we'll be able to see some recovery in the corporate and medium-sized enterprises, but not very aggressive.

Maybe Michela can complement a little bit on what we see particularly in—

Michela Casassa

Yes, I just wanted to add to what Luis Felipe was mentioning. I mean, there is this positive effect of the replacement of the Reactiva loans which is healthy. So, remember I mean, there were almost S/ 60 billion injected in loans to the financial system for commercial loans in 2020 during COVID times, and those loans are being repaid. But there is still—we, for example, lent S/ 7 billion out of that and we still have S/ 3 point something billion in our portfolio. So, basically what is happening is that as those loans which had low rates continue to mature, companies need to replace that cheap funding with new working capital.

So, that's why when you look at the numbers excluding those repayments of Reactiva, actually commercial banking continues to grow. It will continue to be the case for the rest of the year and a part of 2023.

Rafael Borja

So, at this time, I'm showing no further questions. So, I would like to turn the call over to the operator.

CONCLUSION

Operator

There appears to be no further questions at this time. I'd like to turn the floor back over to Ms. Casassa for any closing remarks.

Michela Casassa

Okay, thank you very much. Again, thank you, everybody, for joining us and for joining us also during our first Investor Day. We hope to have a little bit less volatility in the coming quarters and expect to see you in our third quarter conference call results. Bye, everybody.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines at this time.