Company Participants

- Daniel Maria, Head of Investor Relations

Other Participants

- Jorge Kuri
- Tito Labarta

Presentation

Operator

Good morning, everyone, and thank you for waiting. Welcome to Banco do Brasil Third Quarter 2019 Earnings Conference Call. This event is being recorded and all participants will be in listen-only mode during the company presentation. After these, there will be a question-and-answer session. At that time further instructions will be given. (Operator Instructions)

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Before proceeding, let me mention that this presentation may include reference and statements, planned synergies, estimates, projections and forward-looking strategies concerning Banco do Brasil, its associated and affiliated companies and subsidiaries. These expectations are highly dependent on market conditions and on the performance of domestic and international markets, the Brazilian economy and banking systems. Banco do Brasil is not responsible for updating any estimate in this presentation.

The call will be hosted by Mr.Daniel Maria, Head of Investor Relations. Mr.Daniel Maria, you might -- you may now begin.

Daniel Maria {BIO 17030121 <GO>}

Hey, thank you. First of all thank you all for attending our conference. Let's start on page 4 with some earnings highlights. We delivered an adjusted net income of BRL13.2 billion in the first nine months of 2019. This represents an increase of -- a growth of 36.8% in relation to the same period last year.

The fee income in those nine markets represented BRL21.7 billion. That is a growth of 7.3%. In terms of administrative expenses, the cost has increased below inflation, growing 0.7%. That represented in a nominal terms BRL22.9 billion.

Cost-to-income ratio we delivered again the best index in our sales, reaching 35.7%, improvement of 204 basis points in relation to the same period last year. And in terms of profitability return on equity, we reached in this quarter 17.5%, an increase of 429 basis points in relation to September of last year.

Now moving to the next page, Page 5. We bring just our profitability and showing that we have been increasing quarter-on-quarter our results consistently. And this quarter specifically, we brought BRL4.5 million in terms of adjusted net income and this represented a growth of 33.5% in relation to the same quarter last year and 2.5% in relation to the last quarter. The same thing can be seen in the behavior of the return on equity that is shown here on the right hand side of our slide.

Moving to the next page, Page 6, we bring you the NII that grew 1.5% in this quarter and 4.9% in the last 12 months. This growth we have some trends. First of all, we see movements in terms of changing the mix of the portfolio. For instance, the income coming from the individuals portfolio is growing, the participation. We have also a reduction in the cost of funding, and mainly this is related to the judicial deposits that we are in a process of reviewing some contracts. And you can see reduction in the cost itself of those lines. And certainly treasury contributed positively this quarter to the results. I would say that the trend is that for the next quarter probably the treasury will not bring the same sort of contribution due to the environment that we see, but we expect to continue growing in terms of NII.

The next page, we bring NIM, the behavior of NIM. NIM reached 3.95%. That is an increase of 6 basis points. The NIM certainly reflects two events, one event is the change in mix and secondly, the relationship of the loan portfolio to the total portfolio. On the right hand side, we bring here the spread for credit operations. That is pretty stable quarter-on-quarter and increasing when we compare to the same period last year.

The spread for individuals was 16.34%, for companies 4.93, slightly below, and we can explain this behavior for the company's portfolio, mainly because part of the portfolio, mainly those companies that are in chapter 11 they are related to the same group that is not accruing interest on this, and this can explain part of that movement, and agribusiness 4.59%.

On the next page, Page 8, we bring the fee income. Fee income reached BRL21.7 billion in the nine months of 2019. This is a growth of 7.3% compared to the same period 2018. For the fee income, there is an effort of the bank to diversify the fee -- the sources of fee income and certainly we are increasing -- we are working to increase the penetration in our customer base, including the non-account holders and also using analytics to understand better the customer behavior and certainly in a way that we can leverage the potential of the fee business for the bank.

On the next slide, Slide 9, we bring the admin expenses and some ratios -- some efficiency ratio. As I said, costs grew 0.7% below inflation and this reflected a better cost to income. 35.7 it was what we reached. And in another perspective, the coverage ratio, considering the fee business, how much coverage the administrative cost has reached 93.8%. And with these two metrics that are important, the number of employees that we ended the quarter with, 93,870 of employees and this is after concluding the severance process that we started at the end -- at the beginning of the quarter, and also a reduction in the number of branches and there is two movements here, converting branches into points of services and also shut down some of the branches.

Moving to the next page, we bring the loan portfolio. The loan portfolio in an expanded view. It was almost stable compared to the last quarter. On the right hand side of the slide, we bring the dynamic of this portfolio and then showing that the retail business is growing much faster compared to the other parts of the business. There are individuals and SMEs as you can see there.

Wholesale and agroindustrial is the same movement. Basically can be explained by the different dynamics in capital markets that is bringing a higher business remediation [ph] process, and Banco Brasil BB Investimetos is having a relevant position in bringing those companies to capital markets.

And on the bottom part of the slide, we bring another perspective, just showing how much of the retail operations we present in our total portfolio compared to the same period of September last year, movement from 36% to 39.6%.

On the next slide, we bring -- Slide 11, we bring the individuals loan portfolio. The portfolio increased 10.2% in the last 12 months. And I'd like to highlight here the growth in the non-payroll loan that increased -- that moved actually from 27.5% of the participation in the individuals loan portfolio to 29.1%. Then this is in line with our strategy to gain more relevance to those lines that offer better margins, and just some of the products that are driving this performance, for instance the consumer finance that grew 73% September '18 against September '19 versus September '18 and credit cards that increased 14% in the same period.

Now moving to the next slide, Slide 12, we bring loans to companies and in an expanded view, we see that the portfolio decreased and it's 5.4% in the last 12 months and 1.3% in the last quarter. This reduction is exactly that movement that I observed previously about the large corporate segments and this process of migrating to capital markets and Banco do Brasil participates in this process.

On the right hand side, we bring you the SME portfolio of companies with revenues up to BRL200 million. You see that the inflection point for this portfolio happened. We bring a growth and mainly some lines of credit driving this growth, for instance, working capital that grew 40.3% and revolving credit growing 35.1%.

The next slide, 13, we bring the agribusiness portfolio. There are two movements. First of all let's start with the yellow part of the portfolio is the agroindustrial. Agroindustrial is reducing, is the same strategy or the same approach as the large corporates and Banco do Brasil is having a protagonism in this process of disintermediating those companies and certainly offering CRAs or CDCAs or other capital markets instruments for this. On the other -- and looking or observing the blue part of those bars that is basically what we call rural loans, we observed a growth of 0.8% September '19 against September '18.

There is another interesting movement that I would like to point out here that the individuals gain more relevance in this portfolio, growing 4.5% and this helps in terms of profitability as well, and the bank has a market share of 65.1% in terms of rural loans.

Now moving to Slide 14, we bring you the ALL expenses, The credit provisions was BRL3.3 billion in this quarter. We had some reinforcements in this quarter relatively to the specific case. In terms of cost of risk, we reached 3.14%, but if we exclude this large restructuring case or this large Chapter 11 case, I would say that the portfolio is below the 3%.

Moving to the next slide, we bring the credit quality, Slide 15. NPLs over 90 days ended the quarter at 3.47%. If we take out the specific case, our NPLs over 90 days would be 2.74% and the same rationale for coverage ratio. Coverage ratio excluding the case is 213%.

Moving to the next slide, we bring -- we drill down this -- the NPL by segment. Then we have the following movements. Individuals growing a little bit, and this growth can be explained by a growth in the restructuring portfolio. Usually, we see a seasonality in this portfolio that tends to be more pressured in the third quarter that tends to be better in the fourth quarter. And also some of the movements are in the channel [ph] as the mix. The companies portfolio that the individual NPL is 3.9, if we exclude the specific case and shows a downward trend. It is exactly because we are generating -- we are underwriting better credit quality in new vintages.

And also agribusiness. Agribusiness that reached 1.7%, excluding the case. In the case of agribusiness, there are two perspectives. The growth in the third quarter comparing to the second quarter can be associated to some of the cultures that are more pressured in terms of price and -- but this is manageable and when you compare on an annual basis from September '18 to

September '19, certainly this change in terms of the agribusiness reducing the total portfolio has a contribution in this growth that naturally can explain this trend.

Now moving to the next slide, we show the new NPL. This is Slide 17. We show the total NPL also excluding the specific case and separating by segment.

Now moving to the next slide, we bring the capital base of the bank. We reached 10.24% of CET1 this quarter, and on the bottom part, we bring the adjusted dynamic of this. We contributed in terms of retained earnings with 0.53 basis points -- or 53 basis points and we had also one relevant aspect that reduced capital that was in investments. With the Distribuidora [ph] selling the participation at IRB increases the participation, increases the investment in the company and there is a rule that is used to allocate capital and depending on that, there is a threshold for that rule that is extensive. And actually we had a situation that was above that that required additional capital needs. However, when the Distribuidora pays the payout, this has to be reported. Then we expect -- we understand that this is an intermediary situation.

And finally going to the next slide, Slide 18 -- sorry 19, we bring our guidance. By the way, we interrupted our guidance during the follow on. And we just reestablished the guidance yesterday with a material fact and we did some adjustments in the guidance. Adjusted net income, the new -- the revised guidance is from 16.5% to 18.5%. And also in the case of rural loans that we brought a new level of 0.5% to 3% growth.

In terms of the performance, we delivered BRL13.2 billion in the adjusted net income, in line with the guidance when you annualize, the NII 4.6%, in line with the guidance. Loan portfolio is minus 0.1, also in line. Individuals portfolio, we are growing close to the upper part of the guidance with 10.4%. Companies portfolio, minus 8.6% below the guidance. However, we expect -- actually, we expect to converge to the guidance in the fourth quarter since we have some repayments that are being expected.

In rural loans comparing to the new guidance, we are at 0.8%. Provisions, minus 10, and we expect to be inside the guidance. Fee income, 7.3% in line -- in the top part of the guidance and administrative expenses, 0.7%. below the guidance. However we expect to converge to the guidance in case some events happen in the fourth quarter.

I thank you and the let's move to Q&A session.

(Question And Answer)

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Tito Labarta from Goldman Sachs.

Tito Labarta {BIO 20837559 <GO>}

Hi Daniel. Good morning. Thank you for the call. A couple of questions. First in terms of your loan growth. It continues to be below the peers. I understand you're still -- you're not really growing in large corporates, agribusiness is also not growing, but even consumer lending was a bit below the peers, that make 2% quarter-over quarter. So just thinking going into next year, the economy improves, capital is increasing for you guys. How should we think about loan growth for next year? And then I guess second question, with the recent cost savings that you announced, do you think there could be more cost savings into next year and can efficiency improve further. And I guess along those lines ROE is already at 18%, like can ROE expand further? Thank you.

Daniel Maria {BIO 17030121 <GO>}

Thanks Tito for the question. Let's start with the loan growth. Actually, it's hard to compare with the peers because they have different movements. For instance in our individual portfolio, the auto finance, for instance that most of the banks they have full insight. Our main channel for auto finance is through Banco Votorantim and this is not integrated in our portfolio and also -- but I would say that we're growing exactly the way we want to grow and this can be proven looking at the guidance and mainly flirting with the top part of the guidance. We have space for changing the mix in this portfolio and to monetize better this customer base.

For next year, how we can think about the dynamic of this portfolio? Certainly we are working with the budgets. That's just explaining the trend. First of all, this large corporate portfolio, we see a space to reduce a little bit as I showed comparing our performance to the guidance by the end of the year. I would say that for next year, you could have some reduction, yes, but it's close to the inflection point. Then we expect in that with a more benign economic scenario to have a better growth in terms of the total portfolio and the action in the SME portfolio, individuals portfolio and stabilizing the large corporate portfolio. And going to the cost savings, certainly each step ahead is more difficult when we did such a movement, but there is always something to do,yes and we will work on this.

I would say that most of the redundancy that we have in our network we address, and we are evaluating this consistently, and if it's necessary to continue converting branches or whatever, we are going to do it because we are observing that. And we need to look at this exactly comparing to the customer behavior. Nowadays we have 82% of our transactions done through digital channels. Just as a reference, three years ago, it was 62%. Then people -- we are putting available more options and people is getting used to use. And certainly this affects the inflow in the branches.

There is also another metric that we use to measure this that is the maturity of our customer base, what we call digital maturity is a proprietary model that we have and we try to categorize and understand the customer behavior. We have 53% of our customers that we consider digital mature. They use often the X or the Internet or whatever, the digital channels. On the other hand, we have 47% of the people that they are in different levels of digital maturity and what is the work the bank is doing is educating and showing the benefits and we expect to migrate more people to reach the profile. We will never be 100% digital because this is not our value proposition. We want to have to mix this, but certainly, this changes the way you service people and you can have in smaller branches and you can have more optimal network.

And related to the return on equity, I would say that we see space for continued growth. Certainly in terms of efficiency, as you said, and in terms of the fee business, although all institutions they have their challenges. We see space for monetizing that and this customer base, and the usage of analytics is one important aspect we have a lot of data insight and we are using this data, we have been using this data to understand the customer behavior and to address options that fits with that, with the customer needs, yes.

And certainly having a specialized service that you have people close to the customers, and there is also one factor that we expect specifically for next year is to reduce the legal risk. This year we did work to anticipate part of those cases, trying to find, how can I say, agreements for that. We were successful in a certain way because we showed increase in the legal risk. What we -- we are cleaning up this process and we expect that for next year we are going to reduce this by half. Then this is another important driver to continue delivering better results. Those are just some of the drivers we can consider for that movement. Did I address your points?

Tito Labarta {BIO 20837559 <GO>}

Yes, that was helpful and very thorough. Thank you, Daniel. If I could ask just one other question, sorry, in terms of the pension liability rate, it's been -- now you've had a pension liability for like two quarters, about BRL3 billion. Just any concerns about that and particularly, given your capital, just how do you see that and how should we think about that?

Daniel Maria {BIO 17030121 <GO>}

Okay, Tito. I would say that certainly we are mentoring this and the actual is always -- we have some variables that we have no control on that. One of them is the interest rate that discounts the cash flow and certainly the curve is reducing. And this movement puts some pressure yes. On the other hand, you have the assets of the pension and certainly usually when the interest rate goes down, the asset tends to go -- goes up and you see for instance probably Bovespa is the best proxy since most of the investments are in Brazil is showing records.

Then I would say that one thing tends to compensate the other, but it's too early to say because since you take into consideration the price of the assets in the last day of the semester, yes. There is a downward trend due to the interest rates, but it's manageable and we are confirming this, but it's early to say what would be the impact.

Tito Labarta {BIO 20837559 <GO>}

Okay. Thank you, Daniel.

Operator

Our next question comes from Jorge Kuri from Morgan Stanley.

Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning, everyone. I wanted to get a view on your effective tax rate for 2020 and we saw a pretty big jump between 2018 and 2019. And so it's just a bit hard to figure out how that's going to play out next year, and given the very low tax rate that you had for the first nine months of this year, that could mean a limitation on your earnings growth next year. Any comments would be appreciated. Thank you.

Daniel Maria {BIO 17030121 <GO>}

Okay, Jorge. Thank you and thanks a lot for the question. I would say that structurally we see our tax rate excluding the equity income in the region from 18% to 23%, and why this is -- we see -- we understand that business structure. Certainly, we have some of the portfolios that are related to the agribusiness. They bring s some tax shield for us and reduces the tax rate. We have one situation when you compare '18 to '19 is the better usage of the tax shield due to the IOC. You know that there is a limit to pay IOC -- pay the shareholders through the IOC. As we go further and we increase the results, we approach those limits, but we are paying fully as IOC. And certainly our peers, they are not -- they are above that limit, then they need to pay part of this. Then this distorts a little bit the tax rate, those two components.

I would say that comparing '18 to '19 is tricky because you have so many things happened in those years, that makes more difficult. For instance, we have the social contribution tax in different levels, '18 and '19. In '18, we had -- we were consuming tax credit at a rate and appropriating tax credits at a different rate that normally increases the tax rate. For that reason, we give the exercise to find what is the structure rate.

Talking about the future, certainly we are going to fine tune those structural rate for next year and we are going to address the market as we have (inaudible). But I would say that the best proxy we have in our rate is 18% to 20%, and considering that we are going to have higher and social contribution rate, just adding up four to five basis points to this range. Is it clear?

Jorge Kuri {BIO 3937764 <GO>}

Sorry. So if we think about your effective tax rate, so exactly what you're going to pay including all of the different moving parts that you talked about, what do you think is the right effective tax rate for 2020?

Daniel Maria {BIO 17030121 <GO>}

'18 to '20 -- '20 to '28 adding 4 to 5 basis points comparing to the structure rate.

Jorge Kuri {BIO 3937764 <GO>}

Alright. Great. Awesome. Thank you very much.

Daniel Maria {BIO 17030121 <GO>}

We're going to fine tune this. This is the best proxy we have nowadays.

Operator

(Operator Instructions) This concludes today's question-and-answer session. Mr.Daniel Maria to proceed with his closing statements. Please go ahead, sir.

Daniel Maria {BIO 17030121 <GO>}

Thank you all for the attendance and please let us know if you need additional follow up, and have a nice weekend. Bye.

Operator

- That does conclude Banco do Brasil conference call for today. As a reminder, the material used in this conference is available on Banco do Brasil Investor Relations website. Thank you very much for your participation, and have a nice day. You may now disconnect.