Q1 2019 Earnings Call

Company Participants

- Daniel Alves Maria, General Manager and Head of Investor Relations

Other Participants

- Carlos Gomez, Analyst
- Gabriel da Nobrega, Analyst
- Jason Mollin, Analyst
- Yuri Fernandes, Analyst

Presentation

Operator

Welcome to Banco do Brasil First Quarter 2019 Earnings Conference Call. This event is being recorded and all participants will be in a listen-only mode during the Company's presentation. After this, there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions). This conference call is also being broadcast live via webcast through Banco do Brasil website at www.bb.com.br/ir, where the presentation is also available. The replay of the conference call will be available through the phone number +5511-2188-0400 until May 17, 2019 in English and Portuguese. To access the replay, please ask the operator to listen to BB's conference call. Identification will be required. Participants may view the slides in any order they wish.

Before proceeding, let me mention that this presentation may include reference and statements, plan, synergies, estimates projections and forward-looking strategies concerning Banco do Brasil, it's associated and affiliated companies and subsidiaries. These expectations are highly dependent on market conditions and all the performance of domestic and international markets, the Brazilian economy and banking system. Banco do Brasil is not responsible for updating any estimate in this presentation. With us today we have, Mr. Carlos Hamilton, CFO; and Mr. Daniel Maria, Head of Investor Relations.

Mr. Daniel Maria, you may now begin.

Daniel Alves Maria {BIO 17030121 <GO>}

Hi, good morning everyone. First of all, welcome everybody to the earnings release for the first Q 2019.

Let's start the presentation on page 4 with some earnings highlights. The adjusted net income reached BRL4.2 billion in the quarter, implying that growth of 43% over the same period of last year and 10.5% to the 4Q18. The return on equity grew 426 basis points in 12 months, reaching 16.8%. Mostly, this [ph] shows a robust cost control, with administrative expenses reaching BRL7.6 billion, a growth of 1.7% in 12 months below inflation. Fee income grew by 3.8% to the same period of last year, reaching BRL6.8 billion. The cost-to-income ratio was 36.9%, the best one in the -- in our historic series [ph]. The net allowance for loan losses, which is BRL3.1 billion in the quarter, a decrease of 26.3% over the same quarter of last year.

Moving to page 5, within our profitability, that increases consistently. Given the results obtained in the first quarter, we see a reasonable possibility of ending the year on the top end of the guidance for net income. That is between -- just reminding that is between BRL14.5 billion and the BRL17.5 billion.

Page 6 represents the NII that show a growth of 1.8% in the quarter and 6.3% in 12 months. Treasury grew by 3.3% in the quarter and 30.4% in 12 months. The profit-taking in some treasury positions is the main explanation for that performance. In the quarter, the loan income decreased BRL103 million, affected mainly by the reduction of the loans revenues from the agribusiness and portfolios abroad. Having fewer days in the quarter also affected negatively the income of some credit lines.

On the other hand, we highlight the growth of the revenues from individual loans, driven by increase of the portfolio, mainly the non-payroll loans, especially consumer finance. Despite the decrease in the company's portfolio in the quarter, its revenues remained almost stable when compared to the previous quarter, mainly due to the growth of the balance in revenues from the SME working capital portfolio, showing a positive contribution of the mix change of both portfolios, as we have been saying.

The funding expenses were impacted positively by fewer working days in the quarter. However, the increase in the average balance of the judicial deposit raised those expenses, and they were partially offset by the lower average Selic rates. The decrease after institutional funding expenses was due to maturity of some domestic bonds, without the corresponding renewal.

In this quarter, the NII was on the upper section of the guidance, mainly driven by the Treasury, as I commented. This may not happen again in the upcoming quarters. It is relevant to highlight that the NII once again is one of the drivers for our results, mainly due to the mix change on the loan portfolio to more profitable lines, both individuals and company transactions.

Moving to page 7, we present the fee income growth of 3.8% in 12 months. Just highlighting here, the increase of 5.4% in checking accounts, 6.9% in asset management, and 33.5% in Group credit. We expect the fee performance to converge to the guidance for the year.

On slide 8, we bring the administrative expenses, and we show that it's under control, growing 1.7% in 12 months, below inflation. Let me comment on the information to the market -- release that we mentioned to the markets recently in -- as we released it on last Wednesday they did approve a new proposal for changes in the bylaws of Banco do Brasil's employee healthcare plan. And in case of this approval by the associates, an additional expense of BRL586 million is expected for 2019. By the way, our guidance was built considering these expenses.

On page 9, we bring the loan portfolio on the expanded view, that increases 1.9% in the quarter and 0.8% in 12 months. Note that individuals portfolio increased its shares on the total portfolio to 29% from 27% in March -- that was in March '18.

On page 10, we present the loans to individuals that increased by 1.3% in the quarter and 8.9% in 12 months. Growth in the non-payroll loans, especially consumer finance, which grew 85.9% year-on-year is the main driver for the individuals portfolio. The non-payroll loans increased its shares on the portfolio to 14% from 13%, that was in December '18 in line with our strategy. As payroll loans grew by 7.4%, with the disbursements through mobile growing more than double compared to what we observed in the first quarter of '18.

The individuals portfolio performance -- performance was as we expected and should be on the top of the guidance throughout the year. On page 11, we bring the loans to companies on the expanded deal, that decreased 3.7% in 12 months and 4.9% in the quarter. Leading the guidance approach that we exclude the loans to the government. The portfolio dropped by 7.1% in 12 months. This portfolio reduction can be explained mainly by the repayment of loans on the large corporate segments.

This quarter, we show a new breakdown -- we represented the new breakdown for the SME segment -- for the SMEs, comprising -- those companies with rough annual revenues up to BRL200 million. Despite the decrease on the balance of this portfolio, mainly due to write-offs, we highlight the growth of 22.1% of working capital and receivables, reflecting the strategy of growing in line with better risk-return.

The decrease in the large corporates, the volume was expected. But not as fast as it happened. This explains the performance below the guidance for the company's portfolio.

Moving to slide 12, we bring the agribusiness portfolio that grew by 1.5% in 12 months and reduced 0.7% when we compare to December last year. The rural loans, which are considered in our guidance -- which is used for our guidance represented in this graph in -- by the blue bar, were stable in the quarter. In 12 months this portfolio grew 4.4%, near to the middle of the guidance. The agroindustrial portion decreased by 4.7% in the quarter. This can be explained and it was expected in a certain way -- due to those companies have -- has other funding availabilities such as capital markets.

The bill increased its share in loans with the market resources. The disbursement of the '18-'19 harvest plan increased by 88% compared to the previous years -- to the previous harvest I would say.

Another highlight I would like to point out here, is the growth of 308% of the CPRs. CPRs is a negotiable instrument for agri business, that is very common to use as working capital, and it grew 380% in 12 months.

On page 13, we show the net allowance for loan losses of BRL3.1 billion in the quarter, as a result of better (inaudible). There is a reasonable possibility to end the year in the lower region of the guidance. The cost of credit it is improving quarter-on-quarter, reaching 3.11%.

On page 14, we show the credit quality of the total portfolio. NPL over 90 days end of the quarter a 2.59%. The slight increase was due to the reduction in the portfolio since the balance of the NPL remained stable, almost stable over the last quarter. The coverage ratio increased to 214% and the new NPL was 0.69% and coverage ratio, which was 109%.

Page 15, we bring the credit quality by segments. The NPL over 90 days for the individuals ended the quarter at the 3.25%, and this can be explained mainly by the mortgages. On the other hand, the salary loans and the payroll loans improved. NPL for companies continues improving reaching 3.03%, while the agribusiness reached 1.68%. Coverage ratio for individuals reached 187%, agribusiness 192%, companies 247%. We present the new NPLs by segments on the charts on the right hand side.

Page 16, we show the NIM that remained stable in the quarter. The mix change in the individuals, companies and agribusiness portfolio helped NIM. However, the high level of liquid assets to the earning assets offset these improvements.

The trend for 2019 is a slight increase in the NIM, and basically due to a gradual increase of credit portfolio. Once the loan portfolio tends to gain more relevance into the earning assets, we believe that NIM tends to grow. In addition, the improvement is coming from the mix change in the NIM also.

Page 17, we bring the spread by segment. The (inaudible) spreads for the credit portfolio increased 14 basis points, positively impacted by companies, especially working capitals portfolio that helped as well.

On the next slide, slide 18, we present the BIS ratio and the changes in the CET during the last quarter. CET1 reached 10.53% on March, just calling the attention to the fact that the phase-ins, all the phase-ins and phase-outs of Basel-III have already been implemented. And the increase in the CET1 was driven basically by earnings and by lower credit RWA.

Finally, moving to page 19, we summarize the performance related to the guidance. We have -- we mentioned about each line along the -- throughout the presentation, but just consolidating. Adjusted net income, BRL4.2 billion, NII growing 6.3% in 12 months. Loan portfolio growing 0.9% and then we have the breakdown, individuals growing 9%, decrease of 7.1% on the company's portfolio increase of 4.4% in the rural loans. The net allowance for loan losses, reaching BRL3.1 billion. Fee income growing 3.8% and administrative expenses growing 1.7%.

Saying that, we conclude our presentation, and we can go to Q&A. Thank you for the attention.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions). Our first question comes from Gabriel da Nobrega from Citibank.

Q - Gabriel da Nobrega {BIO 20868817 <GO>}

Hi everyone and thank you for the opportunity to ask questions. I would like to make a question regarding your NII. During the quarter we saw that this continued to be supported by your solid results in treasury, which as you already mentioned, cannot be sustainable going forward. In the meantime, while we also saw your improving asset mix growing much strongly in retail loans, we still did not see this really impacting your credit NII, as it actually decreased slightly during the quarter. So, what I wanted to ask you, is if you believe that throughout the year, the improvement in mix could still help you to sustain the NII and thus reach your 2019 guidance, or could a fiercer competition begin to impact spreads?

A - Daniel Alves Maria {BIO 17030121 <GO>}

Gabriel, thank you for the question. We assure that this change in the mix of the portfolio certainly will help to grow NII. And we have good signs of that. Good example, for instance the company's portfolio reduced. However, the income were almost stable, and including this change in the portfolio is important, because although, you have more competition, you see that we are maintaining spreads. Yeah, then this is -- this is quite important for this strategy and we are confident related to reaching the guidance along the year.

Q - Gabriel da Nobrega {BIO 20868817 <GO>}

All right. That's very clear. And if you allow me a second question, we see that loan growth continues to be below what you have been guiding. Sorry, loan growth has been below what you have been guiding. However retail credits have been coming in strong, while corporates are lagging. Well then -- what I want to know is, if there are any strategies that could be implemented in order to see a turnaround of your corporate loan book?

A - Daniel Alves Maria {BIO 17030121 <GO>}

Okay. Gabriel, actually, we can explain this performance for credit portfolio, mainly due to the large corporate portfolio. And certainly, we were expecting for this year that some repayments could -- would happen. Actually it happened much faster than we expected. Yeah, then, this is the main reason for being lower this quarter. As you can imagine, we are talking about BRL10 billion. Although, we see reactions, we see more disbursements in the medium size and small companies, it takes time for that. Yeah, but again we understand that it's still -- we need to observe. Certainly there is a flag that we need to follow-up with. It's early to say how this will behave. But we are confident that we have a space in the medium segment -- small and medium-sized companies to grow that portfolio.

Q - Gabriel da Nobrega {BIO 20868817 <GO>}

All right. Thank you.

Operator

(Operator Instructions). Our next question comes from Yuri Fernandes from JP Morgan.

Q - Yuri Fernandes

Thank you, gentlemen. I have a question on the legal risk. I recall you have been committing that for the first half, this may continue to be under pressure. So just would like to know, like what should is the normal levels of the legal risk? How much should we expect for design? Thank you.

A - Daniel Alves Maria {BIO 17030121 <GO>}

Okay, Yuri. Thank you for the question. Legal risk, actually we were expecting high legal risk for this year. In this quarter -- and we guided -- we flagged last release that the third and the fourth quarter of last year was a good proxy to assume in this quarter. However, we observed higher amounts of legal risk this quarter and these can be seen positively, because since we are in this process of trying to do agreements related to thousands of -- of those legal risks, this means that we were able to anticipate part of this process that we were expecting. Yeah.

I would say that for the second quarter, you can make something very similar to what you observed in the first quarter. Yeah. And then a reduction for the third and fourth quarter. Yeah. It's hard to say where is going to be the inflection point. But it seems to us that's the third and the fourth quarter seems reasonable.

If you estimate, the third and the fourth quarter, I recommend to you to use the third and the fourth quarter last year. Yeah. Then this is normalizing. Yeah and certainly 2020 going more to -- in line to what we observed in the previous years.

Q - Yuri Fernandes

That's clear. And I have a second question regarding the time -- the judicial deposits you have, which were made [ph] very high at 111% of the CDI. What can you do to improve this line? How should we see -- because given you can (inaudible) yourselves with term deposits with a much lower cost, why should we continue to see this line is so expensive? Thank you.

A - Daniel Alves Maria {BIO 17030121 <GO>}

Okay. Thank you, Yuri. Actually, you know that those agreements that we have with the courts for judicial deposits, usually is an agreement for five years and we have several agreements. Then what we are doing is exactly renegotiating those agreements. At the moment, we have a window for that and we are negotiating this. We were able to reduce some of them, and some we're working on. Yeah, I would say that once you have these agreements of judicial deposits, you need to accept the deposits that you have. Let's assume, if you have an increase in any case or any situation, you increase naturally the balance of design. Then, we are working on this. Yeah. And certainly we can show improvements in this line.

Q - Yuri Fernandes

I think, you have like a big contract that should be renewed this year right, for one of the biggest court account, it shows --

should we expect a lower average cost for this line in 2020?

A - Daniel Alves Maria {BIO 17030121 <GO>}

Certainly yes. That's fair. We are negotiating that. Then I cannot give you more details about. But certainly, yes.

Q - Yuri Fernandes

Okay. Thank you.

Operator

Our next question comes from Mr. Carlos Gomez from HSBC New York.

Q - Carlos Gomez {BIO 15024854 <GO>}

Hello and good morning. I wanted to ask about the tax rate, and you have referred to this in the Portuguese call. But do you think you need changing your guidance quite drastically. So I wanted to confirm that you are now stuck between 18% and 23% and that you think that that will be the sustainable rate going forward? Second, I would like to ask you, what the next steps for Cassi might be -- when the new proposal might be put to a vote, and when we should have an answer your employees?Thank you.

A - Daniel Alves Maria {BIO 17030121 <GO>}

Okay. Thank you, Carlos. For the questions. Starting with the tax, we showed our best guess for the tax rate last earnings release, saying that the range would be from 23% to 27% as you mentioned. Yeah. And certainly, we viewed this, based on a series of facts. Yeah, certainly, how much tax credits we are going to activate or we going to use and those guidances, we consider also, those guesses we consider also, which are the composition of our revenues and expenses that could impact the tax -- the effective tax. Yeah. And also the -- to activate tax credits, it depends on a variety of issues. For instance, which is going to be the tax rate or not the tax rates, but the foreign exchange rates, which is going to be the losses that could be the deductible on this. Then we fine-tune all those events, and we understand that 18% to 23% is the best we could look at right now looking at information we have.

I would say that we are -- we understand that this is sustainable and one way to look at this, is to do an exercise comparing to 2018. For instance, 2018 to 2019 first quarter is completely different, but the three main aspects. For instance, payouts in 2014, 40%. Payout in 2018 first quarter, 30%, and certainly higher payout reduces the tax rate.

Second aspect, last year, we were creating tax credits at 40% and we were consuming those tax credits at 45%. What is the effect on the effective tax rate, it increases. And this year, we are creating and consuming at the same rate. This reduced the tax rates. And thirdly is the effect of the social contributions lowering 5%. Yeah. Then, we did an exercise comparing on trying to emulate those numbers for the first quarter of '18. Now the number is quite similar. Exactly for that reason, we understand that this is sustainable.

And now, going to the next question about Cassi. The consultation to the employees will start soon. We expect that by the end of this month, we are going to have this concluded. And certainly, as soon as we have it, we are going to notice to the market what was the outcome.

Q - Carlos Gomez {BIO 15024854 <GO>}

Okay. And to confirm your guidance for expenses is not affected by whether the Cassi agreement is accepted or not?

A - Daniel Alves Maria {BIO 17030121 <GO>}

No. Thank you for reminding me this, you're right. Yeah, when we built the guidance, we included this expense we were expecting. Then there is no impact in the guidance.

Q - Carlos Gomez {BIO 15024854 <GO>}

Thank you so much.

Operator

(Operator Instructions). Our next question comes from Mr. Jason Mollin, Scotiabank.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello everyone. My question is on competition on the loan side of the business. Even the largest Brazil have been pushing this year and talking about growing their loan books, and we've seen new entrants looking for robust growth as well. Can you talk about the competition on lending rates, maybe provide some color if Banco do Brasil is offering the lowest rates in the market for similar risks, and maybe address some comments we saw in the media about President Bolsonaro asking Banco do Brasil to lower rates? Thank you.

A - Daniel Alves Maria {BIO 17030121 <GO>}

Okay, Jason, thank you for the question. First of all, certainly, the market is quite competitive. Yeah. And when you look at the competition, certainly for Banco do Brasil, that we are present in several markets, in several regions, you have different levels of competition. Certainly, in the large CDs, you have more -- all the banks acting there, in some some states it's more -- in some products more specifically. Let me give you an example, our payroll loan is an environment that is very competitive and interest rates compressed. I will say -- I tend to say that we are close to the bottom, but certainly it's compressed. Certainly, there are other -- how we can compensate these, changing the mix of the portfolio, going to other lines of credits. For that reason, the change of the mix is quite important to maintain or even to increase a little bit our stress, yes. As you can observe in the management spreads that we are showing.

Yeah, there is another aspect also. Is the -- depending on the region, we have different levels of competition and certainly, when we have a national wide portfolio, this reduces the risk of being concentrated in just one market. The bank -- however, the bank is acting this market share is -- the most important aspect for the bank is the profitability, showing the right -- the right return on equity, and return on assets for our customers and being competitive in the market. Then we realign it with our peers. And certainly, we are working towards having better services, using technology to be close to our customers. For that reason, it's important to have more customers being serviced by a manager, understanding better the customer, and the psyche of the customer to offer the first -- the products.

Related to the news that you mentioned, I would say that the bank takes all the decisions related to rates using the corporate governance. We have our risk appetite, we have our modules, we have our -- the committees that we see -- that decides which are these interest rate levels, and this is the way we are acting. Then I would say that, this was a comment, a very informal comment that escalated, but the bank decides technically, how we define rates.

Q - Jason Mollin {BIO 1888181 <GO>}

Very helpful. Thank you.

Operator

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

A - Daniel Alves Maria {BIO 17030121 <GO>}

First of all, thank you all for the questions and for participating in the conference call. We -- from the bank and especially the Investors Relations team is available for any further questions, and thank you for the attention again. Have a nice one -- have a nice day.

Operator

That does conclude Banco do Brasil conference call for today. As a reminder, the material used in this conference call 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.