# Q2 2019 Earnings Call

## Company Participants

- Daniel Alves Maria, Head of Investor Relations

## Other Participants

- Tito Labarta, Analyst

## Presentation

### Operator

Good morning, everyone and thank you for waiting. Welcome to Banco do Brasil's Second 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 broadcasted 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 +55-11-2188-0400 until August 16, 2019 in English and Portuguese. To access directly, please ask the operator to link into DB Conference Call +55 11 2188 0400 until August 17th, 2018, in English and in 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 references and statements, plans, 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 the performance of domestic and international markets, the Brazilian economy and banking systems. Banco do Brasil is not responsible for updating any estimates in this presentation.

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

### Daniel Alves Maria {BIO 17030121 <GO>}

Thank you. Good morning. Welcome, everybody to our earnings release conference call. Yes, let me start on Page 4 with some highlights of the results. The adjusted net income reached BRL8.7 billion in the first half and resulting in a growth of 38.5% over the same period last year. Fee income grew 6.7% comparing to the first half '18, reaching BRL14.2 billion. Administrative expenses increased only 0.3% in 12 months, below inflation, reaching BRL15.2 billion in the last year. We achieved a cost-to-income ratio of 36.2%. That represents an improvement of 170 basis points in 12 months and, by the way, the best level of our series. The return on equity grew 455 basis points in 12 months, reaching 17.4%.

Now moving to Page 5; we believe our profitability that has been increasing in the quarter consistently as we have guided the market. In the second quarter '19, we had an adjusted net income of BRL4.4 billion, representing an increase of 36.8% over the same quarter last year and 4.4% over the last quarter. This performance is mirrored in the return on equity growth.

On Page 6, we present the NII that grew by 2.5% in the quarter and 3.2% in 12 months. In the quarter, NII grew due to changes in the mix of the loan portfolio and this is the main reason for that performance, and also treasury contributed positively to the improved performance. We highlight the increase in revenues from individual loans, and this is mainly driven by the portfolio growth and certainly coming from the consumer finance and payroll loans. Despite the increase of the company's portfolio in the quarter, revenues from this segment grew 1.6%, mainly due to the mix improvement and a good increase of the SME portfolio. Treasury contributed to NII with 12.7% in growth in the quarter and 25% growth in 12 months. The treasury results in the quarter can be explained by increasing revenues in treasury transactions, such as repos, current revaluations and contribution coming from the operation of (inaudible).

Moving to Slide 7, which shows NIM. NIM reached 3.89% and was a reduction of 8 basis points in relation to the previous quarter. Such reduction can be explained by decreasing the local assets in relation to the total assets. I would tell you that just as a proxy, if you consider the same composition of local assets to the total assets of last quarter and you compare to this, if you do, what would happen, our NIM should increase 12 basis points. On the right side of the slide, we bring the spread of (inaudible) portfolio, which product required operations increased by 25 basis points, with a positive impact coming from the corporate, individual segments, mainly explained by the improvement in the mix of the portfolio as we are going to discuss ahead.

On Page 8, we show the growth in the fee income by 6.7% in the first half '19 when comparing to the same period -- certainly comparing to the same periods of the previous year. On the right-hand side of the slide, we highlight the performance of the main lines that contributed to that growth.

On the next Slide 9, the administrative expenses remain under strict control as we show, and they improved 0.3% year-on-year. We present on this slide also some efficiency metrics and its performance in the recent quarters. The cost-to-income ratio reached 36.2% and administrative expenses coverage by -- or the administrative expenses coverage by fees reached 92.2% [ph] in 12 months. Those are the best ratios of our series. Furthermore, according to the material fact that we disclosed to the market in July 29th, Banco do Brasil launched a set of measures for its institutional re-organization. And this shows the continuation of the process to look for -- to increase the operational efficiency of the organization. The impact of those measures, we expect sits close to the market, the final numbers by the end of August.

On Slide 10, we bring you the loan portfolio on an expanded view, and that shows a decrease of 0.4% in 12 months, an increase of 0.2% in the quarter. And the reservation, the it's been a portfolio increased 32.6% -- or increased in a way that represents now 32.6% of the total performance comparing to June last year, that was 29.7%. On the right-hand side of the slide, we show the portfolio evolution from June '18 to June '19, that we show exactly this movement that individuals and SME portfolio growing, the retail operations growing, the wholesale part of the transaction reducing, and this certainly helps as we discuss the composition of the mix of the portfolio, although the EBITDA further reduces.

On Slide -- on Page 11, we present the individual loans that increased 9.6% in the last 12 months and 2.8% in the quarter. The non-loan (inaudible) loans increased their share in the portfolio from 13.3% in June to 14.9% in June '19 and really in line with our strategy to change the mix inside these business portfolio being more relevant, the (inaudible)

line of credits. Performance -- as I said, performance was driven by the consumer finance that grew 90% in the last 12 months.

On next Slide 12, we bring the (inaudible) companies on an expanded group that decreased 3.7% in 12 months and remaining stable in the quarter. On our guidance, we exclude for the guidance purpose, the most governments. When assuming this approach, the portfolio dropped by 6.3%. However, the reduction can be explained mainly by the dynamics of the large corporate portfolio, that there is a migration to capital markets, that we have been observing in the last quarter. And actually, our guidance at the beginning of the year, when we disclosed our guidance, we mentioned that. On the other hand, it is possible to observe that inside the -- we mark on the right-hand side of the slide, the SME portfolio and on the other hand, it's possible to denote it, that the growth was driven by working capital lines.

On slide 13, we show the Agribusiness portfolio that reduced by 2% in 12 months and 1.4% compared to March '19. The rural loans, which are considered for guiding purpose, which is represented in the blue bar, was stable in the quarter. In 12 months, this portfolio grew 2.4%. The agro-industrial part of this portfolio that is marked in yellow decreased by 35% in the same period. This was the same process optimization to capital markets that we mentioned that is happening in the hurricane [ph] . In July, we announced the 2019, 2020 quarter event, and we foresee a disbursement of BRL103 billion, that's 20% higher than when that happened in the previous harvest.

Now moving to Slide 14, we show the net allowance for loan losses of BRL3.6 billion in the quarter. The increase in write-off provisions is explained, among other facts, by the higher provision made toward the fixed stage that recently filed for initial recovery, (inaudible) into Chapter 11 in Brazil. The cost of credit risk reached 3.09% in the quarter.

On Slide 15, we show the credit quality of the total portfolio. The NPL over 90 days ended the quarter at 3.25%. You can observe a dotted line in this graph. And this basically shows -- to demonstrate that this increase was impacted by this specific case. And if we do not consider this specific case, our NPL ratio should be -- or would be 2.61%. The coverage ratio has essentially increased to 217%. That's disregarding the specific case.

Slide 16, we bring the credit quality by segment. The coverage ratio for individuals reached 184%; for companies, 240%; and agribusiness, 228%. Just a caveat, those two cases which considering the specific case that we show the number, including the cane [ph] result. The NPL over 90 days for individuals ended the quarter at 3.31%, mainly due to mortgages. On the other hand, the payroll loans improved. The NPL for companies reached 3.84%, while the Agribusiness portfolio ended at 3.08%, both impacted by the specific cases. If we exclude those cases, the NPL would be 3.23% for companies and 1.54% for agribusiness.

Slide 17, we show -- we present the new NPL for the total portfolio and also by segment. We do the same exercise, excluding the specific case for the new NPL. And what you can see that it was almost stable when we exclude the case. We do the same exercise for companies and agribusiness.

Moving to Page 18, we bring the BIS ratio and evolution of the bank's CET1. The CET1 ratio reached 10.01% in June. We call your attention to the fact that all tradings and tradeoffs have already been implemented. The decrease of CET1 can be mainly explained by the actuarial assets that reflected within the semiannual revaluation that we did for the benefit plans, and that impacted -- that was impacted basically by the movement of the yield curve in Brazil. The bank in Q1 was impacted by 107 basis points due to this movement that was partially offset by the net income in the period. And by the way, you will be able to find in our balance sheet and also in the risk report that we publish a sensitivity analysis on the several variables, how this result -- how this could behave (inaudible) .

Finally, on Page 19, we summarize the performance related to the guidance. First of all, we made some changes and adjustments in the company's loan portfolio, adjusting the wholesale movements -- adjusting to each movement in the wholesale segment. Then the guidance now is moving to a decrease of 10% to 13% in the companies' portfolio. The performance in the individual's portfolio that is (inaudible) highest part of the guidance, we bring the new guidance increasing to 8.11%. And the combination of both movements resulted in an adjustment, an adjusted of guidance for the total portfolio from a decrease of 2% to an increase of 1%.

So on saying that, let's move to the performance. Adjusted net income reached BRL8.7 billion. And if you analyze on the highest part of the guidance, NII ended the semester with growth of 4.5%. The loan portfolio grew 1.1%, and this can be explained by the increase of 9.7% in the individual's portfolio, a decrease of 6.3% in company's portfolio and an increase of 2.4% in the rural portfolio. The net allowance for loan losses reached 6.7%. And again, if you analyze inside our guidance, fee income grew 6.7% in line with our guidance and administrative expenses, 0.3%, below our guidance.

That concludes our presentation, and we can move to Q&A. Thank you for your attention.

# Questions And Answers

## Operator

(Operator Instructions) Our first question comes from Mr. Tito Labarta from Goldman Sachs.

## Q - Tito Labarta {BIO 20837559 <GO>}

A couple of questions. First, I know you commented a bit on CLO in the Portuguese call, but just want to get a sense, is there any situation where you would consider selling your stake in CLO , even if you maybe license them back to get the acquiring? I know you said this is a core business. But just wanted to -- under what situation could the government force you to sell it? There was some press reports saying that the government may consider that. So just want to understand if there's any situation where you would consider selling CLO. And then a second question, just in terms of your loan growth guidance, particularly on the corporates, right? The guidance implies that corporates will continue to decelerate for the rest of the year. But at what point do you think you'll get to an inflection where you could begin to grow that loan portfolio? I mean does that begin to grow next year? And just want to get a sense of what's going to -- where there's going to be some kind of inflection point on the corporate lending?

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

Okay. Thanks for the questions. First of all, related to CLO. I would say that the business of acquiring, it's very related to the business of the bank. Okay. And it's -- the restructure of the system, it's something unthinkable, not having these operations as soon we structure that you have for the market nowadays. Then I would say that the result of our discussions. And when you said mentioned about the controlling shareholder, the company has its own governance, the precedence are business-driven. And the composition of the market -- again these are core business for the bank? Yes. And if it makes sense for the business, if I -- looking at the structure of the market that we have nowadays and all the investment benefits that you have of having these operation sites, there is no reason to change that. Exactly the market is what -- in a way that these will affect up on ourselves with everybody. Yes. For that reason, we reaffirm that we don't consider that possibility because with all the conditions we have now. Yes.

And now for loan growth; I would say that depends on the speed of these movements. Yes. Because when we establish our guidance at the beginning of this year, we were expecting large corporates. Yes. Actually, what happened that was much faster than we expected. And this was due to the dynamics of the capital markets, mainly the dynamics of the interest rates. And again, there is a huge inflow in the local funds, and we are looking for assets. And why not optimizing or servicing the companies in the best way and optimizing the capital -- utilization of the capital of the banking because as you saw the two businesses for the bank (inaudible) grew 11%. Yes, I would say that it's hard to tell you what's going to be the inflection points, mainly because when you have a repayment of BRL10 billion, you can imagine how many transactions we need to do to compensate that. Yes.

## Q - Tito Labarta {BIO 20837559 <GO>}

Right. So you think that the corporate lending, given the lower interest rates and more disintermediation, this should continue to be weak even into next year? Is that a fair assumption?

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

Yes, I think it is. And if we assume that the composition in our portfolio in terms of the large corporate, I'm not saying that large corporates is not important for the bank, on the other way, it's very important. It's only the way to service those customers. Yes. And the composition, if you look at the composition of our large corporate portfolio relatively to the markets, it's a little bit higher. Then I would say that it's probably a good proxy to seek, it's an approximation of what you see in the other -- in the first.

## Q - Tito Labarta {BIO 20837559 <GO>}

Okay, that's helpful. Maybe -- sorry, just one follow-up. There was an asset quality issue this quarter, mostly provisioned for. But did asset quality, in any way, play a role in that lower guidance? Do you expect any other asset quality issues for the rest of the year related to a large corporate?

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

I would say that certainly, this is the main case that we have, yes, and certainly this case is (inaudible) yes, because it's a group, one company entered into the Chapter 11 in the first half. The second happened in the second half, yes, in the third quarter. Yes. And however, in terms of provisions, we are comfortable with the level of provisions we have. Yes. This could have some impact in NPL's potential, I'm sorry to say. But in terms of provisions, we are going -- we are well positioned. And again, in the recent guide, we are marking our NPLs, excluding this case, is exactly to show how it structurally our portfolio is behaving.

## Q - Tito Labarta {BIO 20837559 <GO>}

Okay, that's helpful. But just to clarify, so part of the lower guidance for corporates is not because you're expecting more NPL issues, this was really just one specific one and you're not expecting any others. That didn't impact the loan growth guidance?

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

Sorry, if you can say it again.

## Q - Tito Labarta {BIO 20837559 <GO>}

Yes. The asset quality issue this quarter, did that have any impact on the lower corporate loan guidance? For example, do you expect any other asset quality issues impacting your corporate loan portfolio? Or is it just this one case, and that's pretty much it?

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

No, no the guidance has nothing to do with the NPLs or different dynamics. And the guidance is basically the dynamics of capital markets. Yes. And we can see that once this is not concentrated in segments and so on. And these are natural movements that we see all the projects happening in the assets on the asset side, on the capital market side. I think that the (inaudible) what is normal in any developed economy, that capital market is more active.

## Operator

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

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

Well, thank you all for your attention, for the questions. And we're available for any further clarification or questions. And have a nice weekend.

## Operator

Thank you. 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.