

Y 2020 Earnings Call

Company Participants

- Daniel Sonder, Chief Financial Officer
- Marcela Bretas, Investor Relations Director
- Unidentified Speaker

Other Participants

- Carlos Gomez Lopez
- Thomas Peredo

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call of B3's Earning Results for the Fourth Quarter of 2020. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session, and instructions to participate will be given at that time. (Operator Instructions) As a reminder, this conference is being recorded and broadcasted live via webcast. The replay will be available after the event is concluded.

I would now like to turn the conference over to Mr. Daniel Sonder, Chief Financial Officer of B3. Please Daniel, you may proceed.

Unidentified Speaker

I don't think Daniel is in the same room. He's saying that -- we're trying to connect him. Just one second, please. Hi, Daniel. You can go ahead.

Daniel Sonder {BIO 18250247 <GO>}

Okay. Good morning, everyone. I'm sorry for (inaudible), and I just (inaudible) well during these times. We're happy to have you here for the conference call (inaudible) 2020 and some discussion about the year as well. So I have Marcela Bretas on the line and also the rest of the Investor Relations teams alongside. And I just wanted to take this opportunity to thank everyone in the team as well as the IR, accounting and communication teams for put together all these materials that we have in front of us.

Just a brief discussion about the highlights of 2020. I think needless to say we had a very challenging year. We saw a lot of pain in the economy and we saw a lot of pain in personal lives, and we obviously were ready to work hard and trying to fulfill our

institutional mandates here at the B3 of being the platform that everybody can rely on in terms of capital markets infrastructure.

And it -- we also saw a big development in the capital markets in Brazil at the same time. So it's kind of a paradoxical scenario where there was a lot of distress and economic troubles around us, but in the capital and financial market there was significant growth. We reached that low interest rates, low inflation, and the possibility of having fiscal consolidation in Brazil in the medium to long-term are the main reasons for that reaction by investors.

We have the lowest interest rates ever in Brazil at around 2%, nominal rates for the short-term. We have stable inflation around 4.5% for the year, and this really led to significant growth in terms of both the supply and demand for riskier assets which we are managing through our platforms here at B3.

To give you some numbers, total equity offerings in Brazil last year raised BRL118 billion. So that's one indicator of the strength of the supply side of new stocks coming into the market. On the demand side, I think the number to look at are the numbers of (inaudible) number of retail individual investors that have accounts in the depository for stocks, and that reached BRL3.2 million. I think some of you who have followed us for a long time remember what this number was, (inaudible) of what we have now. Even the growth year-on-year was very, very significant, I mean, (inaudible)

And also, in fixed income we can go on in more details at the further pages, but (inaudible) number. Bank funding for the year reached BRL13 trillion. That all translated into this operational performance when I look at average daily traded volume for cash equities reached BRL29 billion of debt on an average. BRL4.3 million contract in listed derivatives and all of this represents significant growth versus the year before. And we also look at the fixed income and the realization (inaudible) reaching BRL25 trillion.

So the result of all that was significant growth in our operating results, as you will see in a minute. But I will just a few more developments that we saw in the company. We were able to execute our roadmap versus some relevant items that we delivered, including BDRs for all types of investors now in Brazil, (inaudible) of our insurance platform, so we're now serving the insurance industry with technological infrastructure for registration.

We moved forward in our energy initiative, those are still very, very small compared to the total numbers of B3, but they are, in our view, the seeds for new businesses that may become relevant one day. We also delivered number of standard products or things more in the nature of the business. The options are (inaudible) which is (inaudible) product, securities lending stream and the secured financial deals for funding of banks.

We also are happy to report on the operational excellence of our platform. We saw unprecedented volatility in volumes as I mentioned before, and this really put a lot of stress and demand on our systems with 2x the average number of trades coming through in 2020 versus 2019. We expect even higher than this 2x multiple. And we were able to do a very good job, thanks to the hard work of my colleagues in operations and IT, not only

last year, but (inaudible) building the resilience that (inaudible) right now, and our numbers were very good and we didn't have any problems.

We also did move on our pricing schedule. We had a commitment which you won't have heard us refer to of sharing gradually over time the benefits of scale and operating leverage with our clients. And in February, we implemented one important step in that direction for the cash equities market, and we will continue to do other initiatives in that area.

And finally, with respect to distributions and cash generation, we had a very, very strong year for cash generation, and we also were able to distribute that out to our shareholders, considering revenue of the company. And we reached BRL6.2 billion of distributions, including interest on capital, dividends and the buyback program. (inaudible) this was aligned with the high-end of our guidance for distributions of 150% of accounting net income.

I'll now turn to Marcela (inaudible) about some of the segments and businesses (inaudible) back to Q&A.

Marcela Bretas

Good morning, everyone. This is Marcela here. Nice talking to you all, and hope everyone is healthy and safe at this challenging time. I'll briefly go through the main highlights of each segment for the last quarter of 2020, and then I will talk about the financial results.

So starting with the equity segment, ADTV in the quarter was BRL31.6 billion, up 67% from last year. Driven, as Daniel mentioned, by low interest rates which propelled investors to look for portfolio diversification and increased demand for equity. And also by some level of volatility that has permeated through 2020 results.

On the derivatives market, ADV was slightly below the fourth quarter of 2019 or 6% below, reaching 4.3 million contracts. But our RPC raised 54.3% year-on-year, driven mostly by the real depreciation since part of our contracts are priced in U.S. dollars.

In the OTC segment, new fixed income issues totaled BRL3.7 trillion, up 40% year-on-year, and that was mostly driven by credit recovery, especially in the last few months of 2020. OTC derivatives issuance was in line with what we observed last year, but outstanding volume in custody increased by 61.6%, since most of these contracts are -- have notional amounts in dollars. Those are swaps and forward contracts with the real depreciation volume in subsidy tends to increase.

In our infrastructure for financing business, we saw some recovery in vehicle financing activity. Compared to the third quarter, volumes were up 16% and compared to last year they were up 3%. So that was a positive quarter compared to a very difficult year for this segment. In fact, that was the most impacted business negatively in terms of volumes by the pandemic.

Finally, in our technology data and services segment, the new OTC pricing policy positively impacted revenues for these line of services, as was the case for the previous quarters as well. And we observed an increase of 6.4% in the number of clients, mostly some in the OTC segment. For data and analytics, we had a positive impact in revenues driven by more product demand and also the real depreciation against dollar since some of our products here are also priced in dollars.

With that, we reached gross revenues of BRL2.5 billion. Adjusted expenses that account for personnel expenses, data and processes expenses as well as some other operating revenues -- operating expenses, sorry, accounted for BRL342 million, leading to an EBITDA of BRL1.7 billion, which represented a margin of 78.7%. Recurring net income totaled BRL1.2 billion for the quarter.

We ended 2020 with a gross debt of BRL7 billion, which represented 1.1x our recurring EBITDA. And finally, as Daniel mentioned, we had a significant return of capital to our shareholders for the year, it amounted to BRL6.2 billion, which is equivalent to the cash flow that we generated throughout the year. And that BRL6.2 billion had BRL900 million with share repurchases and BRL5.3 billion through dividends and IoC.

With that, I think we could open for questions from investors. Thank you.

Questions And Answers

Operator

(Question And Answer)

Ladies and gentlemen, we'll now begin the question-and-answer session for investors and analysts. (Operator Instructions) Our first question comes from Thomas Peredo with BTG Pactual. Please Thomas, go ahead.

Q - Thomas Peredo {BIO 21712295 <GO>}

Hi, good morning, Sonder, Marcela and team. I have two questions. My first question is related to the central registration of credit card receivables, decreasing among the entities authorized by the Central Bank in this initiative, but it could be an interesting market for B3 to enter. So given what happened recently with SIP having problems with -- by with being ready to roll out to the full model and 1,000 regulator to postpone the whole initiative to June. This did -- did this affect in anyhow your interest to enter into this market? How are you seeing this initiative? And if you could also update us on how has been the evolution of the registration of insurance policies, credit bills, the clearing services for bills [ph] and also the energy market? And then, I will make my second question. Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Sure Thomas, let me take that and then Marcela can help me out here. We do plan to be in the business of registration of credit card receivables. So we have an initiative in that

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front. In the -- we think again, it's an opportunity for us as well and we hope that we can support our clients in the market in that need as well as the regulators.

And in terms of the other segments, we have launched our registration platform. This is again something that is relatively small at this point, but we're gaining ground and I think we have been able to capture some relevant clients in this activity. It's not a market where we expect to be alone, there are other players in it, but I think B3 has all the credentials to capture a relevant market share and follow the development of this business. As you know, the regulator started with a few segments within the insurance universe for registration and is gradually going to move, let's say further down in terms of other segments which have bigger scale. So they start to do this with let's say us relatively small universe, but we believe it's going to in the right direction.

The energy platform is still I think a little bit behind although we also believe that it has a good potential in the long-term. This requires let's say a bigger transformation of the market in power contracts in Brazil, this market was deregulated about 20 years ago and there are a number of consumers and producers and brokers, companies in the process. So we're trying to be a platform where things can have transparency and standardization of contracts. So that one knows that if the contract is registered with B3, it meets certain characteristics and out of that, we can begin to have price, data and out of that, we begin to have curves. And then it develops into maybe an OTC market and further along, more sophisticated market like we see elsewhere. Essentially all of the -- let's say technical work has been put in place, but we still are in the early stages of this gathering and send people to join our platform.

In terms of the credit card, just sort of one more detail that I also have mentioned in the credit card receivables. We expect to be ready with the platform in the third quarter. We are testing and working with the regulator to make sure that it meets all its standards. I think I covered most of what you mentioned in your question, but I'll turn it over to Marcela, maybe if there are some additional details.

A - Marcela Bretas

No, Daniel, I think you covered most of the relevant points. And if you guys have follow-up questions, let us know.

Q - Thomas Peredo {BIO 21712295 <GO>}

Okay, no great. It is clear. And for my second question, if you could also give us an update on the retail liquidity wider. So how does the regulator gave the go-ahead or expand from the contracts to other products like equities? And gave more 12 months to test these initiatives. So, how is the timeline for this rollout to other products and overall how have you been seen the benefits versus risk of this product. Obviously, it helped a lot volumes for many contracts, an increase in the liquidity for clients. But also it has kind of an incentive for clients that have a higher trader in short-term profile that are usually not necessarily profitable. So is there any concern on this regard that could require an increase or change in regulations? If you could share anything with us would be great? Thank you.

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A - Daniel Sonder {BIO 18250247 <GO>}

Sure, Thomas. I'll start with the second part of your question. We find that the products that we offer in general, right, are beneficial for market development and for meeting the needs of different clients and having said that, there is a concern that needs to be always in there and that has to do not only with RLP, but with stocks with new IPOs with any type of futures products and so on that clients must be aware of the risks and they must be duly informed either by their own efforts or by the efforts of the brokerage community, which surrounds us that certain products are more suitable or not. There are regulations for that, there are -- I think companies -- most companies in our ecosystem that it is extremely seriously because they want the benefit of their -- and the success of their clients in the long run.

So we obviously, there are people who let's say don't manage properly the opportunity that they have to invest in our markets. But in general, we think that the role of the infrastructure is to provide a set of products that are under the regulatory umbrella, under the supervisor umbrella and under the let's say a network of the brokerage system which itself has the instruments and incentives to do proper client suitability and education of the clients. So that's the general point that I wanted to mention to you. We think that RLP fits within this context, it is an innovation that B3 is proud to have brought to the market. It provided a solution for something that was happening in the market and that happens in all markets that we know which is an increase in retail demand for certain products, which is brought to the retail brokers and there is an opportunity to meet that demand with the other side of those trades coming from institutional investors and particularly high frequency traders.

And if the broker plays a role in matching that, it's in our view only reasonable that they should capture part of the economics of those transactions, and that is exactly what happens in the U.S. market for example through what's called retail internalization, and in Brazil, the solution that B3 innovated with this called RLP, so the principle is exactly the same. It just happens in a different location in our case, we view this positively because again, it is under the supervisory and regulatory umbrella of B3 and with full transparency to the clients and to the regulators.

The CVM has been working with us to further develop this market. As you mentioned, it authorized the expansion of RLP to other products or to other types of assets and instrument. However, it did put some additional demand in this next phase and we are now working with them to see whether we -- whether and how we can best implement and address those demand. And they're not all very clear to implement. But I think in -- we will be successful and try to find again as we did in the original RLP innovation, try to find a compromise between the needs of the market or the wishes of the market and the wishes and concerns of the regulator and try to find a middle ground to make the market move forward.

I think that's how B3 sees itself as this is a reliable partner, which can hear the regulators view and the market view and come up with solutions that are robust, creative and that allow for market development at the same time that we do this with safety.

Q - Thomas Peredo {BIO 21712295 <GO>}

Okay. Thank you. Thank you very much for the answer.

Operator

(Operator Instruction) Our next question comes from the webcast, and it's from Victor Schabbel with Bradesco BBI. He asks, could you guys provide some color about the new pricing policy that was expected to be implemented early this year. Any views that you guys can disclose about the potential revenue impacts given the current volumes? Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Thank you. Maybe I'll turn it over to Marcela, and we can get some more details.

A - Marcela Bretas

Sure, Daniel. So, when we started the implementation of the new intermediate pricing model now in February, this intermediate model was announced back in December and it's an adaptation of the full model that we announced at the beginning of the year, but was facing some challenges in order to implement them at the timing that we felt was ideal. So we were expecting to implement the full model by August last year since there were some systems adaptation challenges and we could not fulfill that timeline. We went back and we draw a new intermediate model that delivers about two-thirds of the economies expected from the full model.

We announced this intermediate model in December and we started to implement now in February. This intermediate model, it provides discounts. It adjusts all prices to the new levels of liquidity. So it reflects the new reality of volumes in our market and it also provides different discounts to day traders and it also makes the adaptations that we are looking for in order to attract more retail investors. So the changes for retail investors and day traders are mostly in place with this intermediate model. We ran a back test based on volumes that we observed during the second quarter of 2020. We annualized those volumes and revenues and what we obtain is that with a full model, we would be providing around BRL400 million in discounts over close to BRL4 billion revenue.

And with this intermediate model, we -- these discounts would be around BRL250 million. So we would be delivering BRL250 million out of the BRL400 million expected, if we were able to implement the full model. So we don't have these numbers updated for the volumes that we've been observing in the first few months of 2021, but that can give you a sense in terms of potential impact on percentage basis. But having said that, it may vary depending on client mix and other factors. We continue to work towards the implementation of the full model. We are just not certain of the timing that will be able to conclude this. And if you guys have any follow-up questions on that, let us know, and Daniel, if I'm missing anything, please feel free to add.

Operator

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Bloomberg Transcript

Our next question comes from Carlos Gomez with HSBC. Please Carlos, go ahead.
Mr.Carlos Gomez, you are in line.

Q - Carlos Gomez Lopez {BIO 19127284 <GO>}

Apologies. So congratulations on a great year. Two very brief questions. The first one, what is your expectations for velocity for 2021 and beyond that obviously you haven't experienced very, very high levels in 2020, how sustainable is that? And I know that's a difficult question. And second, what are your expectations regarding the ForEx derivatives and the expected level of activity and pricing that you've show in 2021 to remain in '22? Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Okay, Carlos. Thank you for the question. So with respect to velocity, as everyone saw during last year, we reached very, very high levels over 170% of turnover velocity. We believe that this was somewhat attributed to the continued uncertainty that was present in all of our markets and this lack of visibility of what was next, really led people to trade more frequently and to move in and out of their positions due to let's say recalibrating their views about health concerns, economic recovery, interest rate trajectory and so forth and the different sectors had very different performances and some companies suffered a lot, some companies thrived.

So all of that led to this huge spike in velocity. But also, I think a component to be considered is the large number of new transactions. So the influx of new investors and of the IPOs really leads to a higher turnover for these stocks in the beginning and as original investors change hands and so forth and there was also a component. It's again -- and thank you for acknowledging this in your questions, it's really hard to predict where this is going to go. I think that we definitely reached a new level if we compare to the 70% to 80% that we saw just a few years ago in Brazil. I think, it's hard to see a scenario where we would just simply go back to that. But again, it's not safe for us to say that we think that a 170 plus is the sustainable new normal.

We'll have to see a period of normality in capital markets and 2020 is definitely not an year that we can call normal. So we think that we're going to have to see a little bit how 2021 plays out, so that I can maybe give you a better answer of where we feel comfortable projecting this level of turnover.

With respect to FX derivatives, it's important part of our derivatives business. We continue to see a lot of activity there as was mentioned, we have two drivers there for our success. One is the actual volume of transactions and the other one is the level of the FX rate, the real to dollars exchange rate and because we collect fees, we charge fees in dollars so that our numbers reported in reals go up when the real weakens. And this is happening right now, and it's so happens historically that when there is more volatility in FX and particularly devaluation. There's a greater rush to hedge and to use the FX derivative market, so we have this on the listed side. We have this on the OTC side and both -- in both cases, we charged dollars and we obviously it will depend on how the currency behaves during the year, but it's -- the last few months are any indication. It seems like we're going to have a successful year in FX derivatives as well. Thank you so much.

Operator

(Operator Instruction) Our next question comes from the webcast and it's from Eduardo Nishio with Genial Investimentos. He is asking regarding RLP implementation, any time expectation? Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

So I think, I addressed this earlier on if the question is regarding RLP. We have the product in place and we have a new opportunity to develop more features, but we're still discussing the timing with the regulator, considering some of the observation and inputs that they gave us for this new face. I don't have a clear date [ph].

Operator

(Operator Instructions) With no further questions, this concludes today's question-and-answer session. I would like to invite Mr. Daniel Sonder to proceed with his closing statements.

A - Daniel Sonder {BIO 18250247 <GO>}

Thank you, everyone for joining the call again. We are available for further questions through the IR channels. And again, I hope everyone is in good shape and that you continue through to manage the difficult times and thank you for your support during 2020. It's been a successful year for B3 and we couldn't have done it without all of you and your continued interest in Brazil and in our markets. Thank you.

Operator

That does conclude B3's audio conference for today. Thank you very much for your participation, and have a good day. And thank you for using chorus call.

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