

# Q1 2019 Earnings Call

## Company Participants

- Daniel Sonder, Chief Financial Officer
- Rogerio de Araujo Santana, Managing Director of Investor Relations

## Other Participants

- Eduardo Nishio, Analyst
- Otavio Tanganelli, Analyst
- Thiago Kapulskis, Analyst

## Presentation

### Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call about the earnings results of B3 for the first quarter of 2019. At this time, all participants are in a listen-only mode. (Operator Instructions) As a reminder, this conference is being recorded and broadcast live via webcast. The replay will be available after the event has concluded.

Now, I would like to turn the conference over to Mr. Daniel Sonder, Chief Financial Officer of B3.

### Daniel Sonder {BIO 18250247 <GO>}

Hello, everyone. Good morning. I'd like to welcome you all to B3's First Quarter 2019 Earnings Call. I'm here with Rogerio Santana, Head of Investor Relations, as well as the finance and Investor Relations team, and I'd like to thank all of them for preparing the document you have in front of you. Additionally, on behalf of the entire executive team, I'd like to thank you for your continued trust and support.

I'll start the presentation on Slide 3, and I'd like to highlight some of the important achievements and figures of the first quarter of 2019. Once again, the quarter was marked by high activity in the financial markets in Brazil and the expansion opportunity -- and expansion of the business opportunities for our clients. In this context, there are two numbers that we want to highlight; the ADTV in cash equities, which reached BRL16.8 billion; and the number of accounts in our equity CSD, the depository, which reached 1 million in March. That's 1 million accounts for equity. There are two other aspects that deserve mention; first, the issuance of debentures by B3 totaling BRL1.2 billion, which was concluded this week and it is in line with our new guidance for financial leverage; second, the revision of our guidance for depreciation and amortization following adjustments on the amortization curve of intangible assets recognized in the business combination with Cetip.

Regarding our financial performance in the last quarter, our revenues grew across all segments. As mentioned in our last call, starting from this quarter, we are adopting a new revenue segmentation aiming to better reflect our business model, services and products. Net revenues reached BRL1.4 billion in the quarter, an increase of 24% when compared to first quarter 2018. Our adjusted expenses reached BRL232 million, 3.1% higher than in the first quarter, which we will explain in more detail later in the presentation.

EBITDA adjusted for nonrecurring items was BRL971 million, an increase of almost 28% over the previous year. And this resulted in an EBITDA margin of 70%, once again demonstrating B3's

considerable operating leverage. Recurring net income reached BRL736 million, a 64% increase mainly explained by the increase in operating results and lower tax -- or lower income tax, pardon me.

And now Rogerio will give more details about our performance by segment.

## **Rogério de Araujo Santana** {BIO 20317880 <GO>}

Thank you, Daniel. Hello, everyone. I would like to actually to move forward to Slide 4, where you will see the performance of the listed equity markets. Revenue in this segment grew 39% year-over-year mainly driven by the 42% growth in revenue from trading and post-trading services in the cash equity and equity derivative markets. The ADTV in the cash equity market grew 48% from BRL11 billion in the first quarter 2018 to more than BRL16 billion in the first quarter 2019. This performance reflects the increasing of turnover velocity from 77% one-year ago to more than 104% in 2019, in the first quarter 2019, reflecting not only higher market volatility, but also higher exposure to equity from individuals and local hedge fund. In addition, the average market capitalization increased by 12% over the same quarter of 2018.

Moving to trading and post-trading revenue line. The ADV of stock index future contracts increased by more than 125%, reflecting the growth in trading of Mini contracts notably by individual investors and High Frequent Traders. It's worth mentioning the increase in revenues from our equity depository, reflecting the higher number of accounts, as Daniel mentioned in the previous slide.

Moving on to Slide 5. You will find details on the performance of the listed fixed income, currency and commodity derivatives market, where we had a 17.4% increase in revenue. Two important factors contributed to this performance; FX volatility, which positively impacted ADV of interest rates in US dollars and the tax rate contracts; and the appreciation of the US dollar against the real in the period, which had a positive effect on the average RPC of those same type of contracts.

Next, in Slide 6, we present the performance of the OTC segment. In the fixed income revenue line, the increase in volume of bank funding instruments, mainly certificates of deposit and real estate credit bills, were offset by the decrease in Treasury Direct revenue due to reductions in our fees and introduction of more aggressive incentive programs, both implemented in January 2019 to promote higher volumes for this project. In derivatives, the higher revenues were a product by the increase in volumes of structured notes and FX-related swap agreements and by the appreciation of the US dollar against the real in the period, which impacted the FX-related derivatives.

In Slide 7, we show revenue for the infrastructure for financing segment, which grew 31% over the first quarter 2018, reflecting the effects of change in the business model of the Contracts System adopted in some states of Brazil in 2018 and early 2019. The National Lien System, or SNG, was positively impacted by the 7.2% increase in the number of vehicles financed in Brazil. Additionally, we had the annual price adjustment by inflation implemented in January 2019.

Moving on to Slide 8. We can see the performance of the technology, data and services segment, which grew 13.4% in revenues. The growth seen in the access and technology line is related to gains of new clients in the OTC markets. In the case of the data and analytics line, the solid performance reflect the appreciation of the US dollar against the real, given that 60% of this revenue line is US dollar-denominated, mainly related to data in their listed markets.

In the next slide, we show the company's adjusted expense, which reaches BRL231.6 million, 3% increase year-over-year. The main factors were the increase in adjusted personnel expense and the consequence of the annual collective bargain agreement in August 2018 and third-party services mainly related to consulting services we hired in the period. On the other hand, data process expenses as a consequence of the decommissioning of one of our data centers.

Now, I will hand over the presentation back to Daniel who will show other financial highlights.

**Daniel Sonder** {BIO 18250247 <GO>}

Thank you, Rogerio. In Slide 10, we demonstrate our financial robustness with a solid cash position and a very healthy balance sheet, which is an important part of the business of being a credible counter-party in the financial market. On the left side, we show the total cash amounted to BRL9.3 billion at the end of the quarter composed by B3's own cash as well as third-party cash mainly related to collateral pledged in cash by our clients. In the light blue bars on this chart, you will find B3's own cash amounting to BRL5.8 billion in the first quarter of 2019, which includes BRL395 million of interest that were already paid out in early April 2019.

On the right side, you see the company's debt profile and amortization schedule. As announced last quarter, our guidance for financial leverage for 2019 is 1.5 times gross debt through recurring last 12 months EBITDA. In line with this guidance, this week, we concluded the issuance of debentures amounting to BRL1.2 billion, bearing interest of 102.8% of PDI.

Finally, our guidance for payout has a target between 120% and 150% of IFRS net income. And in first quarter of 2019, our payout was 62 -- sorry, 65.2% of reported net income.

With this, I'd like to conclude the presentation here and open up for Q&A. Thank you.

## Questions And Answers

### Operator

Ladies and gentleman, we will now begin the Q&A session for investors and analysts. (Operator Instructions) Our first question comes from Thiago Kapulskis with BTG Pactual.

### Q - Thiago Kapulskis {BIO 19187926 <GO>}

Hi. Good morning, Daniel. Good morning, Rogerio. Good morning, everyone. I thank you for the opportunity to make questions. I have two actually today. The first one is related to the expenses. I mean when we're looking to the adjusted expenses this quarter, it came actually pretty much in line with what you -- you were guiding actually for the year, right? And the guidance was actually maintained the way it was. But when we're looking to the total expenses, they had some acceleration this quarter and particularly, the revenue-linked expenses. So if you could give us a little bit of color on these other expenses lines that are not included. How you guys are expecting for these lines to behave for the rest of the year, so we can get a better sense of how to model these lines? So that will be the my first question. And my second one is related to actually the regulatory framework and discussions in terms of capital markets. I mean this quarter we've seen, especially the Central Bank a little bit more vocal, right? They even wrote a special, let's say, section on the financial study report. They also came to the press basically mentioning that promoting or helping the capital markets will be important for the whole economy or -- and even how PDP recovered. Just want to get a better sense of -- if you as a company, how you see that and how the discussions with your regulator are in terms of helping the capital markets. If there are some opportunity that you can see actually in this regard and maybe even in terms of the dual listing, for example, of Brazilian companies? I think those would be my questions. Thank you.

### A - Rogerio de Araujo Santana {BIO 20317880 <GO>}

Thank you, Thiago. This is Rogerio. I will address the first question, and Daniel will take the second one. So first I'll explain the difference what we call adjusted expenses and the total expenses that you see now in our income statements. So we decided to give guidance only on adjusted expense because this is a group of expenses where we have more control and we can manage in a better way. And on top of that, we also give specific guidances for other expense lines, like depreciation and amortization that we adjusted this quarter, revenue-linked expenses and so on and so forth.

So when you look at the adjusted numbers, we are growing very much in line with inflation, actually slightly below that. And it reflects all the efforts of the company to make sure that we have the adequate cost discipline in our culture. When you analyze the behavior of the other lines that are not included in the adjusted numbers, I will highlight two of them. First, revenue-linked expense that's pretty much connected to the performance of the financing segment that we recently remain for infrastructure for financing. Here what we have is the fact that we are testing a new model for the Contracts System in a pilot mode and it is impacting both revenues up and expense up. That's why it grew significantly when you compare it to the first period of 2018. Regarding the second line, as we've see in the group others and is related to provisions, you probably remember that we have a large provision that moves up or down according to the BV -- to B3SA3, our share's market price. And we had in the first quarter 2019, our share price growing significantly and as a consequence, the amount of provisions that we recorded in our books also moving up. And these are the two main highlights I would bring related to the expense performance in the quarter.

### **A - Daniel Sonder** {BIO 18250247 <GO>}

Okay. Thiago, thank you for the question. You're absolutely right that the regulators have been talking more explicitly about the relevance of capital market development for Brazil to recover its growth trajectory. And we are obviously very excited about that because that has been our, I'd say pieces for quite some time as well. In terms of practical development in that front, I would mention three things. One is, obviously, the use of capital markets by government agencies directly to divest from equity ownerships that they hold in several companies, and that is a very strong direction that the current administration is taking and we are pleased about that, obviously. I think it will likely strengthen those companies as well as bring additional volume to those stocks that are traded here.

The second practical action is particularly with regard to the national development bank, the BNDES, a reduction in the rate of growth in the portfolio and the significant drop in the disbursement that BNDES is doing and a change in the direction of the types of companies that they seek to support with their lending. And that will -- in our view assuming that there is obviously growth and projects and -- at the amount of recovery that will bring those companies to the capital markets for both equity and debt, we're already beginning to see the signs of that. But it's obviously an encouraging move by the government.

And thirdly, there is a, let's say, a desire to try to simplify some of the rules pertaining to listing another requirement of already listed companies and new companies that want to come to market. The CVM recently mentioned that it has an expense line a few of these measures that will be -- provision of measure (inaudible) that gives the regulators some additional freedoms to implement more flexible rules regarding the capital market. And again, this is something that we are working together with the regulators to make sure that more companies can come to list in the Brazilian markets. And the dual listing existing that you asked about is in this pipeline, we don't have a concrete timetable for any changes regarding that specific point, but it's definitely within the agenda of discussions among regulators, market participants and ourselves.

### **Q - Thiago Kapulskis** {BIO 19187926 <GO>}

Great. I think it was a good update. Thank you, everyone.

### **Operator**

Our next question comes from Otavio Tanganelli with Credit Suisse.

### **Q - Otavio Tanganelli** {BIO 20615779 <GO>}

Hi. Thanks for taking my question. I have a question regarding the dividend payout ratio. For this year, we do have the guidance from -- ranging from 120% to 150% of the -- of net profit. So what should be the sustainable payout ratio that we should be working with going forward considering the strong cash generation profile of the company? Thank you.

**A - Daniel Sonder** {BIO 18250247 <GO>}

Okay. Otavio, welcome to the coverage of B3. It's good to have you on the call. And with respect to the dividend payout, the way we like to think about it and obviously, that the discussions that we have every single quarter so it's still subject to specific approvals and the negotiations by the Board of Directors. But in general, our stance is that we intend to distribute the entire cash generation of the company going forward. And also, we have guided for a leverage level that is linked to our EBITDA. So 1.5 times total debt to EBITDA, which means that if we have growth in EBITDA, that would give us room again subject to review to further increase our nominal debt level and, therefore, have more cash available at hand for distribution. We think that 1.5 times total debt to EBITDA is a very prudent level that is compatible with the business that we're in and with the perception that we want to have from our counter party, which take B3 risk. And -- but by indexing the debt level to EBITDA we ourselves room for additional distribution beyond the cash that is generated by the company. So I think that's basically how I would try to help you in terms of modeling it. We do not want to accumulate much additional cash in the company. And therefore, that's how we think about it. We -- the way we're going to use (inaudible), which is obviously interesting from a tax perspective, and then we're going to use a combination of dividend and possibly buybacks to further distribute that cash and obviously aiming to deliver the most efficient rate for our shareholders.

**A - Rogerio de Araujo Santana** {BIO 20317880 <GO>}

Just -- this is Rogerio, Otavio, just adding on what Daniel just said, important to remember that we will have for a few more years a difference between our accounting earnings, accounting net income and the cash earnings of the company due to the amortization of intangibles and goodwill. So as a consequence, we will have additional cash generation when you compare to the accounting numbers.

**Q - Otavio Tanganelli** {BIO 20615779 <GO>}

Very clear. Thank you.

**Operator**

Our next question comes from Eduardo Nishio with Plural.

**Q - Eduardo Nishio** {BIO 15333200 <GO>}

Good morning. Thank you for the opportunity. Just a question on the competitive environment. If you can give us an update on the diverse business lines you have competition, ABBC for instance on the liens and loans also? And also, if you can give us some color or some potential -- or your potential initiatives against the US listing, I would appreciate any kind of a -- different kind of listing or governance that you are thinking about to avoid this Brazilian companies to be listed in US, that will be also be very helpful? Thank you.

**A - Daniel Sonder** {BIO 18250247 <GO>}

Okay. Thank you, Nishio. So first, starting with competition, there is no major news on each one of the fronts. So in the fixed income registration or bank funding instrument registration, the project by -- led by ABBC from what we hear continues to move forward. And the -- we don't know exactly when they expect to be operational. But we are keeping track of that and we are staying very clear to our client and trying to make sure that we have the proper products and commercial approach to ensure that we remain their preferred venue for doing such registrations. In liens and loans, as you know, we have a different arrangements depending on the state. In some of them, we are part of a bigger sort of connection chain where there are registration companies involved. In some states, we have not operated for a while, while we try to figure out exactly what the arrangement will be. So -- and as Rogerio mentioned in his states, we are actually testing a new business model, which also slightly the way that the connections are made and who is actually responsible for each part of the revenue collection in this business. But again, it's still not, let's say, a stable environment

in the sense that we can say what we could have said, that there will be no further changes in either states where we operate or not or the actual business model for that segment.

And finally in equity. So as you know, we have an ongoing discussion with a potential entrant that has to do with feeding the depository. Those are ongoing and we don't have a lot of information that we can share, given that those proceedings are confidential. But we also don't know whether the new entrants is already operational or has engaged any client to actually begin their activities once the discussions are settled. That's kind of the status in each one of the front.

Your last point was regarding listings outside of Brazil. We have discussions with our regulators regarding adjustments that should be considered for companies in -- that have certain structures that have led them to list abroad. But it's also important to mention that the listings abroad are at least upto this point very limited to a particular segment, which is the tech segment where, in fact, the United States has been able to create a very positive and attractive ecosystem for listings from all over the world. So we've seen companies from other jurisdictions also seeking to list in the US because the US has created over several years, decades perhaps, a community of foreigners and investors and people that have an appreciation for these kinds of businesses.

That's not to say that we will not try to do our best to attract similar companies to this -- in Brazil. In fact, we have several initiatives in the company to stay close to issuers in the earlier stages and to show the benefits of the listings. And you have to see, I think, it's a combination of also many, many factors, the development of an investment culture in this segments locally. Some rules that need to be adjusted and the engagement of the exchange with the issuers to make sure that they understand the advantages that we also offer. So it's not a one sharp formula.

**Q - Eduardo Nishio** {BIO 15333200 <GO>}

Thank you so much. Just to -- a follow-up on this last point. What are the discussions with the regulators? Can you give us some details? I'll appreciate it.

**A - Daniel Sonder** {BIO 18250247 <GO>}

Pardon? I didn't quite get it.

**Q - Eduardo Nishio** {BIO 15333200 <GO>}

The discussions that you have with the regulators, you are -- I'll say your suggestions to change, what would be any different structure, governance to today's kind of Novo Mercado that probably limited something tax to be listed here in terms of dilution? And if you can give us some thoughts about what could be in the future?

**A - Daniel Sonder** {BIO 18250247 <GO>}

Yes, because it's still ongoing, I'd rather not give too much detail. As soon as we have something to announce, we will make sure that, that everyone is aware of that. But at this point, I'd rather preserve all the discussions that we're having with the regulators.

**Q - Eduardo Nishio** {BIO 15333200 <GO>}

Yes, sure. Thank you.

**Operator**

(Operator Instructions) This concludes today's Q&A session. I would like to invite Mr. Daniel Sonder to proceed with his closing statement.

**A - Daniel Sonder** {BIO 18250247 <GO>}

It seems like we have one more question.

## Operator

Yes. We have one more question from Thiago Kapulskis with BTG Pactual.

### Q - Thiago Kapulskis {BIO 19187926 <GO>}

Hi. Thank you for letting me make another question. Just thinking -- you have mentioned of the time, if you could give us a little bit of an update as well on the roadmap of products that you announced last year? I mean there were a lot of initiatives to improve service or -- and create more engagement to clients and everything. I mean if you could take the opportunity to hear more about that, it would be good? Thank you.

### A - Rogerio de Araujo Santana {BIO 20317880 <GO>}

Thank you, Thiago, for the question. Yes, we are very focused on delivering on this roadmap. As you remember, the first delivery happened in December 2018, when we launched some new products like single stock futures, a new weekly option, some enhancements to existing option contracts on interest rate and FX. And this is evolving and it's a gradual process, so we're seeing more and more clients getting engaged in the trading activity of this product, but it is still very recipient [ph] for us. Now we are focused on other products. We should have announcement for launching in the second quarter 2019. So examples are, we're reducing the settlement cycle from 2 plus 3 to 2 plus 2, sorry, in the equities business. We are also introducing new trading analysis and other types in the system. We should also launch trading screen for secret lending [ph] and few other things in the different business. In the OTC market, we should also launch the registration of receivables in the financing unit. We also have mainly data and analytics initiative as well. So there are many products and initiatives. We are very excited about that. We have aligned it, the privatization of each of them with key clients. It's not something that we design. It's a long, definitely. The prioritization came from our clients and ready to help the market, the Brazilian market become more sophisticated and making sure that different client profile, different brokers and banks will find in B3 all the products they need, all the services they need. So it's ongoing development. We have initiatives for 2019. We have initiative for 2020 as well. When you look at product-by-product or service-by-service individually, we are talking about more potential revenue or EBITDA contribution. But in aggregate, after certain periods, definitely it will help the Brazilian market to grow and as a consequence our business and especially the clients' performance.

### Q - Thiago Kapulskis {BIO 19187926 <GO>}

Just one last follow-up on that. Are you guys already seeing some sort of improvement in -- I don't know if you track MTS or any sort of customer satisfaction or anything like that. Do you already see an improvement with these initiatives? Or it is still very difficult to track that?

### A - Rogerio de Araujo Santana {BIO 20317880 <GO>}

You mean regarding the recent launches or...

### Q - Thiago Kapulskis {BIO 19187926 <GO>}

Yeah. I think it could be overall. But I guess, that the launches help, right, or should help, right?

### A - Rogerio de Araujo Santana {BIO 20317880 <GO>}

Yes. Thiago, we are using MTS (inaudible) to track our relationship and success among clients. We won't disclose how that's going, but it's become, obviously, a measure inside the company, so we can gauge the success of our initiatives and adjust the course of action as we go forward.

### Q - Thiago Kapulskis {BIO 19187926 <GO>}

Understood. Thank you. Thank you, guys.

FINAL

Bloomberg Transcript

## Operator

Now we have a question from the webcast. (inaudible) could you please provide more color on interruptions of services in Parana state?

### A - Rogerio de Araujo Santana {BIO 20317880 <GO>}

This is Rogerio. Thanks for the question. Our services in Parana was interrupted in the fourth quarter of 2018. We are -- we talk about the concept system. We've seen the infrastructure for financing segment. We are working with our clients and also with local regulators to redeem our services. But so far, it has not happened yet. But we are still working with clients and regulators on that.

## Operator

This concludes today's Q&A session. I would like to invite Mr. Daniel Sonder to proceed with his closing statements.

### A - Daniel Sonder {BIO 18250247 <GO>}

I'd like to thank everyone for joining the call. And please feel free to contact our Investor Relations team if you need any further information or access our website where we have provided a lot of operational and financial data as well. Thank you. Have a good morning, everyone.

## Operator

That does conclude the B3 audio conference for today. Thank you very much for your participation. Have a good afternoon, and thank you for using Chorus Call.

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