

Y 2019 Earnings Call

Company Participants

- Daniel Maria, Head of Investor Relations

Other Participants

- Geoffrey Elliott
- Neha Agarwal
- Nicolas Riva

Presentation

Operator

Good morning, everyone. And thank you for waiting. Welcome to Banco do Brasil Fourth 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 the event, there will be a question-and-answer session. At that time, further instructions will be made. (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 55 (11) 2188-0400 until February 21, 2020, in English and Portuguese.

To access the replay, please ask the operator to listen today's conference call, identification will be required. Participants may view it (inaudible).

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

With us today, we have Mr.Carlos Hamilton, CFO; Mr.Daniel Maria, Head of Investor Relations. Mr.Daniel Maria, you may now begin.

Daniel Maria {BIO 17030121 <GO>}

Okay. Thank you. Welcome everybody, to our presentation. Let me start on page four and with some highlights of our earnings. We presented BRL53.1 billion in NII in 2019. This is

increase of 6.4% in relation to 2018. In terms of fee income, we grew 6.4%, that represented BRL29.2 billion at the end of 2019. In terms of administrative expenses, we grew 2.8% below inflation, and we reached BRL31.5 billion. And in terms of credit provisions, ALL expenses, we reached BRL13 billion that is a decrease of 8.6% in relation to 2018. All those aspects combined processed an adjusted net income of BRL17.8 billion, that is a 32% growth in relation to 2018.

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Now moving to next page, Page 5. I bring more details about BB results of the bank. First of all, we are delivering a consistent growth in our adjusted net income quarter-on-quarter, as we show here on the left hand side in the yellow part, and we grew 1.8% in relation to the last quarter. And when we compare to the same quarter 2018, it is a growth of 20.3%. When we compare year-on-year, we have a 32.1%, as I said, reaching BRL17.8 billion in adjusted net income.

In terms of the profitability index that shows the same movement is the return on assets that we moved from 1% to 1.2% and the return on equity that we moved -- reached 17.3% in 2019 from 13.9% what we delivered in 2018.

Now moving to the next page, Page 6. We bring more granular information about the NII. We are delivering growth in NII consistently quarter-on-quarter. On an annual basis, we grew 6.4%, reaching BRL53.1 billion. When you look at the composition, the yellow part in the bar is the main treasury, a contribution. We see growth in the contribution coming from treasury in 2019. And we do not expect the same contribution for 2019 -- 2020 as we're going to describe later. In terms of the loan operations revenues, we see the change in mix being reflected here. For instance, individuals portion of the revenues grew from 49% to 52.5%. Although we have also movements in terms of mix shift coming from companies, this is not completely clear here which has been the portfolio risk, because when we look at the slides, the participation of these new smaller companies have been increasing in terms of the profitability of the asking values, or not the profitability but for the contribution events.

Another important aspect for the contribution in NII is the reduction in the funding costs. This is one of the functions of the reduction in the base rate, since most of our funding is very different. It's slow, and also, in some cases, like judicial deposits.

Now moving to the Page 7. We show the NIM and the spread by portfolio. Actually all that movement related to the change in mix that I mentioned previously is being shown here. Starting in the middle that we show the middle of the slide that we show the managerial spread, we reached 8.19%, an increase comparing to 7.6% for the total portfolio, and this is being driven by all the lines of credit. For instance: Individuals, reaching 16.44%, companies, 5.13% and agribusiness as well. This is one of the leverages for the NIM. The NIM there is a function of the liquid assets for the NIM. Exactly for that reason, we have some volatility quarter-on-quarter. However, we see the managerial spread increasing, and we see the liquid assets being reduced. For that reason, we experienced also a higher growth in NIM. As I said, we expect some volatility quarter-on-quarter, but in the medium term, we see growth.

Moving to Page 8. We bring some information about the fee income. The fee income grew 6.4% year-on-year and when we compare to the last, not to the last but fourth quarter of '18, we grew 3.8%. This growth is being driven by growth in, for instance, consortiums that we grew 29.9% capital markets, 23.7% insurance or the insurance business that grew 18% and checking account and asset management with 6%.

Moving to Page 9, we bring the administrative expenses and the income ratios, which means cost-to-income ratio. We grew 2.8%, our admin expenses below inflation, as I said. We -- representing this in the cost-to-income ratio in the coverage ratio. We see increasing efficiency of the organization. By the way, just an observation here. We well advanced in fourth event in the fourth quarter, that is basically the health plan, Cassi, that impacted fully the fourth quarter. This is related to the full year and what we did here for the cost-to-income ratio, just to avoid some reallocation, is to scrap this amount along the quarters then exactly to show the downward trends and how we are managing the efficiency of the organization.

Another metric is the number of employees. We ended of the year with 90,000 employees, and this is one of the facts of the service package that we launched in the third quarter. And in terms of the bank footprint, we continue the process of optimizing our network. Yes, and basically reducing traditional branches, and we are opening specialized branches and the points of services. And in doing this, we adjust the cost structure for the network.

Now moving to Page 10. We bring more light about the loan portfolio. The loan portfolio, we show the development of all lines here. But most importantly is that we have grown exactly the lines of credit, for instance, as you can see here on the right-hand side, in the most profitable lines individuals, SMEs, the retail and the reduction in the portfolio the deflectors coming from wholesale wholesale and the agroindustrial that by the way, this is a movement that is linked to a different dynamic in capital markets and the bank is servicing those customers through capital markets. There is also a change in the duration of the portfolio that's expressed a little bit of that. And happening all this process, the percentage of the loan portfolio for the retail operations grew from 36.7% to 41.1% of the total portfolio.

Moving to Page 11. We bring individuals loan portfolio and shows the dynamics of change mix in this process. First, payroll loan continues to be a relevant line for our own business portfolio, grew 14.5% year-on-year. However, some lines like consumer finance that has higher profitability is growing at 45.2%. Certainly in terms of the base is different, but this is very important. It need balance with its rewards of the portfolio, and this is one of the reasons why that is contributing to an increase in our return on assets.

The companies' portfolio on Page 12, it's a similar dynamics. We see the co-operative or the large corporate parts of the portfolio reducing. This is the main factor for the growth in this portfolio. On the other hand, we see the stability is much closer and the SME portfolio is growing faster. And the growth in SME portfolio helps the spread for this portfolio since we go to some lines that are not capital. And finally opened, the SME portfolio, w see, for instance,that working capital and revolving credit is growing much faster at 28% and 12.5% year-on-year.

Moving to Page 13, we bring the agribusiness portfolio. The agribusiness portfolio has a seamless movement, the yellow part of the bar here are the agroindustrial loans. Those loans are reducing deposit situation of the portfolio. This is mainly explained by the dynamics of capital markets is very similar to the large corporate. When you look at inside the rural loans, there is also a change in this process. For instance, we see individuals gaining more relevance in the total portfolio and reached BRL159 billion in the total portfolio of BRL170 billion.

Page 14. Will bring ALLL expenses. We've got provisions. We saw a reduction -- a minus reduction of 8.6% year-on-year. This movement can be explained by these two dynamics. First of all, recovery of write-off grew from BRL 6 billion to BRL 7 billion to \$6.7 billion and also the write-offs grew from BRL 20.2 billion to BRL 19.7 billion. Then all these two combined movements explains the reduction in the overall expenses. And in terms of cost of risk, we've reached 3.15% and excluding the large case, we are in the region of 3.7%.

On Page 15, we bring the NPLs. The NPL of the total portfolio reached 2.54%, a reduction of 20 basis points in comparison to the last quarter excluding the larger deals. If we exclude the larger, I want to say, restructuring fess, the Chapter 11 case here, exactly to show the dynamics of the portfolio. And we show exactly the same movement with the conversion, including the case and excluding the case.

On the next page, Page 16, we bring general view about the NPL for individuals, companies and agribusiness. Individuals, as we briefly mentioned in the last conference call, reduced the peak that we observed in the third quarter was seasonal and we saw a reduction to 3.41%. In the companies portfolio, we believe excluding the larger case, it's got to be moved from the 3.09% to 2.49%. This is one of the reasons why we see a contribution to reduction to the debt provisions. And in the case of the agribusiness excluding the larger case, we reached 1.85%. There is one dynamic here that is important to highlight, that is basically the change in mix.

As I said in the previous slide, it's reducing the agroindustrial part of the portfolio, this portion has a lower NPL, however, lower profitability as well. And when we reduced this, we reduce this, the business increases the total NPL throughout the portfolio.

The new NPL that we show on Page 17 and for the total portfolio and for by segments, presents also the reduction from 0.84 to 0.76 depending on the work to 0.5 and the same dynamics is presented in the individuals companies, except in agribusiness. But again, this is something that can be explained by this movement that I explained earlier.

Moving to Page 18, we bring the capitalization of the bank. The CET1, we ended the year with 10.02%. We reinforced our commitment to which by January '22, at least 11% in CET1. What happened in this quarter? We had several moving parts. In the bottom part here on this slide, we present some of these movements. For instance, we had some extraordinary events like the treasury shares that we've sold in the follow on that added some Capital. The equity interest, mainly related to the disregarded dividends and so on. Filling up those assets, we have around 100 basis points. That was consumed by the pricing of the

external positions that was roughly 100 basis points. We have also the repricing of the tax credit and part of this new pricing representing in the consumption of CapEx due to higher tax credits. Then this explains basically the movement that we showed.

Now moving to Page 19. I bring some points about ESG policy of the portfolio. This is a subject that has been working in the last years. It is in the strategy of the bank and in the matrix of the strategic goals. This is embedded in all the actions. This is not new. At least, we participate, for instance, in some of those index in the last 10 years to 15 years. For instance, we are part of the ISE, an index sustainability index by B3. Since the launching of these index in 15 years ago, we are part of the ICO2, that's another index issued by relate to B3. We are also part of the Dow Jones Sustainability index in the emerging markets since 2012. And last year, we, in fact, were included in the global index and we are part of the FTSE index in the last four versions. We are part also in THE Corporate Governance index for the service companies. And we are part of the new markets, that's has the highest standards of corporate governance. Then all those movements and some other initiatives, that I've mentioned here, gave us some important rewards and recognitions. For instance the Global 100 is issued by Corporate Knights and we were among the 10 most sustainable companies in the world for the second year in a row.

Yes, and this index is issued by Corporate Knights and usually is announced in the most. Yes. We are below in Brazilian and Latin American bank in this ranking. This 100 rank the check more than 7,500 companies and this is a reward to all initiatives that we're doing. And we received also the sustainability Award Gold Class in 2020. One of the reasons that expenses shown in our portfolio, 30% of our portfolio can be considered as a green portfolio. Something that has some positive externality. For instance, efficiency, low carbon emission or something related to the renewable energy, sustainability and the business is related to best practices and so on.

On Page 20, we bring the guidance for 2019. We met all our goals in terms of guidance for 2019. Now moving to Page 21, bring more information about the guidance for 2020. Just some internal observations that we had some changes and they're ready to report. The main key harmonized to what you see in the market and also to bring something that just shows exactly what we are presenting to the market. Let me start with the loan portfolio.

For instance, the retail portion of the portfolio is one of the aspects that we are giving more attention, and then we started a new weightage, including the SME plus individuals, that we are calling in retail. And we expect to grow between 10% to 13%. The wholesaler, that is basically the companies, as companies above BRL200 million in revenues and excluding governments, we expect to grow between 2% to 5%. This is one important aspect because after several years of increasing the wholesaler part of the portfolio, this year we see possibility of stabilizing and continue process.

Certainly, the target in this process, we see participation of the large retail companies in this process. Then individuals loans growing 1% to 4%, then all those assets combined gives us a loan portfolio growth between 5.5% and 8.5%. Something that it's important also to highlight is NII, with the NII growth in line with the average balance of this portfolio. And we made the change in the index, because in the past, we reached the

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impairment. This year, we exclude impairments from NII. By the way, we have a proforma in our MD&A, just to help you to understand those movements for margin, and we moved the impairment to ALL expenses.

Basically what we did in the credit provisions, we include the gross spread provisions plus the recovery plus the impairments and plus discounts. And this is basically the given distribution of year and we expect to grow between 10% to 13%. By the way, we got also in our MD&A, the pro forma for 2019 considering these metrics. In terms of fee income, we expect the growth between 1% to 4% and admin expenses between 2.5% and 4.5%. All those aspects combined, we see an adjusted net income in between 18.5% to 20.5% -- BRL18.5 billion to BRL20 billion in 2020.

Just to make some comments about the dynamics of the results in 2019 and 2020. In 2019, the operational of the bank -- the operations of the bank improves a lot, not completely this process was clear because we have higher legal costs. For 2020, we see this process of having strong operation will continue. We expect to have lower legal costs and exactly for that reason, we can have in the medium range of this guidance, growth being between 10%, even though we have growth in the tax rate.

That said, we can move to the Q&A. Thank you.

Questions And Answers

Operator

(Question And Answer)

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions)Our first question comes from Neha Agarwala from HSBC.

Q - Neha Agarwal {BIO 16508665 <GO>}

Hi, thank you for taking my question. I wanted to ask about the recent news that we read about are your card business, are you contemplating the reorganization of the business? And any plans on CLO that has been determined? Thank you. I'll ask next question after.

A - Daniel Maria {BIO 17030121 <GO>}

Okay. We have -- Daniel Maria speaking. Thank you for your question. Actually, you probably heard several rumors in the press about our organization. In the organization, we always review the participation in the business that we have. But something that I can tell you, there is nothing -- in finance, there is nothing in this directions. It's some speculation that we've seen in the market and those rumors, but there is nothing decided, nothing defined in this direction.

Q - Neha Agarwal {BIO 16508665 <GO>}

Okay. Thank you. But would there be if you would like to divest your stake in CLO? Or what would be the challenges for taking such a transaction, in your view, if you can give any color on that?

A - Daniel Maria {BIO 17030121 <GO>}

I think that is one thing that we need to have in mind is the structure of the Brazilian ecosystem. Certainly, when you look at all participants, they have acquirers in their business. The relationship of the acquirer with the banking that certainly, there will be a huge transformation in the future and has been showing transformation. yes. Actually, the aspect and the most complex aspect is how we're positioning ourselves when the market has loan structure. Yes. And the -- probably one million questions, how we view the structure of the market, probably five years and 10 years, that you can create competitive advantage in this market. Then but as I said, there is nothing some speculation. And it's normal that we run our business in a regular way. Even though it's a core, non-core, we need to take a look on business.

Q - Neha Agarwal {BIO 16508665 <GO>}

Okay. Thank you for that. My second question is more on the guidance side. You expect 1% to 4% fee income growth. I believe that is on the lower side when you look at the loan growth, probably impacted due to competition. Anything else that is leading to the lower growth in fee income that you can elaborate on? And the other aspect is the OpEx growth. You've seen that some of your peers have been much more aggressive in controlling expenses, and they would like to close more branches to reduce their cost base. What are your plans in terms of cost control? And do you think you could be towards the lower end of the guidance or mid to high range? Thank you so much.

A - Daniel Maria {BIO 17030121 <GO>}

Thank you, Neha. Let me start with the fee income. Yes. I would say that this income that we are presenting here, we have challenges for it and just making some exercise. yes. In the fourth quarter, we had the full effect full effect of the repricing of the asset management. Just an exercise, if you get the three first quarters and you analyze this and you project of the true effects in the next year, you would have a reduction and just looking this commercially, you would have a reduction of 3.5%. What we are saying here that we are going to grow to compensate this reduction and to grow in the other lines of business. Yeah. Then this is quite challenging. Yes, probably when you compare the composition of the fee income is different from bank-to-bank. In our case, this is the reality. We have a hit that comes from the asset management business, but we see space for compensate in other lines. For instance, asset -- capital markets is one example. Insurance can compensate this. The consortium is something that is going quite fast in Brazil then this is embedded in the assumptions for the fee income.

Going to the admin expenses. Yes, I would say that we started first, this process of reducing the cost structure of the bank. In the last three years or even four years, we have been showing growth through low inflation, very low comparative in inflation. Then certainly, the next step that initiates, it is always more complex. And in terms of branch network, we addressed most of the redundancy that we have, certainly, could have some movements, but this will be more case to case. I don't see a bunch of branches being

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closed. Yes, in terms of personnel, we did a lot. We reduced a lot in the last year. More recently, we announced a new approach for the compensation of the employees. This is something that could bring some savings in the medium run. That's when the bank is addressing all those assets. On the other hand, for this year, we have more expenses, for instance, in marketing. When you have a very competitive market, you need to position yourselves. And this explains for some of the expenses that what we have, it's more related to the business. And this is basically the dynamics that I see for the administrative expenses and why we have those numbers. Is it clear?

Q - Neha Agarwal {BIO 16508665 <GO>}

Very good. Thank you so much.

A - Daniel Maria {BIO 17030121 <GO>}

Thank you.

Operator

Our next question comes from Nicolas Riva from Bank of America.

Q - Nicolas Riva {BIO 20589225 <GO>}

Yes, thanks very much for taking my question. I have a question on the overdraft and what's been announced in terms of regulation. So the Central Bank put this cap of 8% a month, how much you can charge in the overdraft lines? If I look at the contribution to the loan book, it's less than 1% of your total loans, but you charge very high interest rate. I mean once you've given, charge a very high rate in that segment. Have you assessed the impact from this regulation in terms of your net earnings, I mean, also, if you expect more regulation from the Central Bank in terms of caps on interest rates and other credit lines? Thanks

A - Daniel Maria {BIO 17030121 <GO>}

Okay, Nicolas. Thank you. Thank you for the question. First of all, in terms of overdraft, yes. As I said, when you compare the overdraft portion of our total portfolio slower compared to the system. We have lower than 1%. The system is, on average, 2% or 3%. And then the impact of certain -- there is an impact in our balance sheet, but tends to be lower compared to the peers.

We estimate the impact something around BRL300 million to BRL350 million after tax in our NII, yes. What we are -- we see stage compensate in other lines of credit and grow in other lines of credits, yes. For instance, we don't give a loan to a certain extent, yes. Another aspect is the new regulation gave the possibility of charging for the availability of the limit of credit. We opted not to do it. We understand that the overdraft facility is one important product to bring the customer to the bank. Yes. And we can manage this to consume other products and is exactly the way we are tracking this.

Q - Nicolas Riva {BIO 20589225 <GO>}

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Thanks. And then on -- do you see the possibility of the central bank putting caps on interest rates on credit lines besides for the growth?

A - Daniel Maria {BIO 17030121 <GO>}

Nicolas to be very frank, it's hard to predict. I would say that it's less likely, this in specific case. And the way the Central Bank is behaving actually, they put some sort of cap that will create some situation that the banks compete and find the rates, yes. It's hard to say that the extent of Central Bank is increasing competition. But certainly, the extent of Central Bank is bringing more participants to that market. And also -- and opening the market to mainly to feedback is on. And the bank is prepared to compete in this environment. This is what I call a new normal.

Q - Nicolas Riva {BIO 20589225 <GO>}

Hey. Thanks very much.

Operator

Our next question comes from Geoffrey Elliott from Autonomous.

Q - Geoffrey Elliott {BIO 15944940 <GO>}

Hello, good morning. Thank you for taking the question. There's been quite a lot of discussion from your CEO and in the past about a number of the stakes that you hold. So you've talked about being in close to looking for binding bids on the asset management joint venture and you've put out the announcement about a buffer, actually, IPO and you've announced that you're reviewing the card business. Can you discuss what you're trying to achieve strategically here? Is it simply about generating some capital? Or is there something more strategic you're looking to do?

A - Daniel Maria {BIO 17030121 <GO>}

Thank you for the question. It is strategic. What the goal of this management is to prepare the institution for a new competitive landscape. Yeah, and certainly, as I said, reviewing the business is something that is normal. In the case of -- let me give you the example of the asset management. The bank have a huge capacity to make deals. On the other hand, we have the debt. Then the debts are in some business, for instance that is necessary global scale, for instance M&A or advisory. When we made the agreement with UBS, we closed that doing someone with global scale and matching with our organization capability. For the asset management business, although there is nothing announced, what it's the concept of this, we see a huge transformation in the asset management business. And looking at the structure of the market, certainly, you need to have some competitive advantage. Having global scale is one important aspect to this, even though to distribute funds abroad or to assuming that the interest rate will continue at low levels certainly, a global location will be part of the daily business that we have invested here. Then having a global partner is something that you put the Institution for this new normal. But although -- I'll give you two examples, just to see this to show how the management thinks about us. How we are -- how we see the future of that business? What's going to be the competitive advantages in this new environment? What we need to fill the gaps to

reach it? It's not necessary to build up capital. We are building up capital organically. Yeah, and we are quite comfortable with our products.

Q - Geoffrey Elliott {BIO 15944940 <GO>}

Thank you. So when you're thinking about a partner in asset management. What are you looking for them to bring to the table?

A - Daniel Maria {BIO 17030121 <GO>}

Okay, when you look at the asset management business here in Brazil, and you're probably -- think it's -- let's say, part of the history of the high interest rate environment. Most of the allocation issue fixed income. And fixed income is exactly the funds that are having more compressive fees. Certainly, there is a migration to more sophisticated strategies. Yes. And some of them probably bringing a different dynamic, you can start to deliver. Also, in terms of having a global location or having capacity to build global access, this is another aspect that you can bring to this.

And again, it's clear it is another important aspect to this. And then we see a huge transformation in the market and having a lot of innovation in how we can speed up the process of innovation inside the Bank. And we understand that a global partner and this process brings a differential to the market that probably -- it is a competitive advantage comparatively to the peers.

Q - Geoffrey Elliott {BIO 15944940 <GO>}

Thanks very much.

A - Daniel Maria {BIO 17030121 <GO>}

Thank you.

Operator

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

A - Daniel Maria {BIO 17030121 <GO>}

Okay. Thanks you all for the attendance. We keep available here for further questions. And thank you, thank you again. Have a nice day.

Operator

That does conclude the 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.

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