

Q2 2019 Earnings Call

Company Participants

- Alexandre Riccio de Oliveira, Vice President
- Joao Vitor Menin, Chief Executive Officer
- Unidentified Speaker

Other Participants

- Eduardo Rosman, Analyst
- Unidentified Participant

Presentation

Operator

Good morning. Thank you for waiting. Welcome to Banco Inter's Conference Call for the Second Quarter of 2019. We have today, our CEO, Joao Vitor Menin; our Vice President, Alexandre Riccio de Oliveira; and our Investor Relations Director. Ms. Kol Vera [ph]. All participants are just listening, and this is being just recorded.

Then, participants will be -- will participate in the Q&A session with further instructions being provided. (Operator Instructions) This is also being recorded in a webcast mode and it can be accessed in ri.bancointer.com.br. This will be available after the call is ended. Participants of this webcast can also record or send questions to Banco Inter, which will be answered by our Investors Relation Department. We'd like to inform that this conference call is being translated into English for -- to cater for our foreign investors.

Before we continue, we'd like to clarify that any statements that may be made during this conference call, relative to business outlooks at Banco Inter projections, operating and financial targets are just based on the premises of the Company's management.

Based on the information that's currently available to the bank, forward-looking statements do not ensure performance because risks and uncertainty may be involved and it depend -- and they depend on circumstances that may occur.

Now, I'd like to give the floor to Mr. Menin who will start the presentation. Over to you, Mr. Menin.

Joao Vitor Menin

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Good morning, everyone. First of all, thank you very much for participating in another conference call earnings release. This is a very special earnings release call. Like the first after our IPO, this is our first earnings call after our follow-on offering, a highly successful operation. We'll talk about that later.

Well, I believe and I will start our earnings release call by thanking deeply all our employees over 1,300 and also our investors, we have almost 90,000 investors and especially our customers. These people were responsible for making this semester or even this quarter to be really special. In fact, outstanding with great results, very promising results that will help us continue our banking revolution. Some of the highlights of our quarter include in the first half of 2019, as well. And these include growth of 1.1 million of new account holders.

We made our deal with Seguros, a very interesting deal to launch the first digital insurance service in Brazil. We're really excited about the prospectus the outlook. We've also completed, as I said before, our follow-on offering, highly successful, by the way. And finally, last but not least, we had our greatest quarter profit of the bank in the last 25 years. I'd like to highlight that although, we had positive results, we know there is a lot of room for improvement. In other words, we are really strong in our path of making a revolution in the financial industry, Brazil. We have our first digital free account in Brazil. We've already done this with investment in our Open Investment Platform, PAI, it's already on our app. We also were the first to launch our fund cashback and also 100% digital and free home broker services, and we're doing the same now with insurance. We are making a revolution in the insurance sector. So we now have digital insurance services in partnership with Wiz and also in credit. And this is easy to understand, to understand our revolution in loans. We have extremely low rates or fees in Brazil for many different products like payroll loans, credit cards. We also have a credit or payroll loan operation of very large portfolio in Brazil, that's 100% digital, without intermediaries and paperless. But we want to do more. We know that this revolution is, of course, very positive and very important for all Brazilians. But we also believe that we can do more in terms of services, non-financial services, and this is being encouraging us to launch our Super App. Our Super App will be an increasingly better experience for our customers.

In addition to everything else that they can do, they only may also consume services and products from our app. And this Super App will also provide people the possibility of getting money in their current or checking accounts with the operations and transactions they do through our app. So we have this cashback possibility.

And then, by the end of the year, beginning of next year, we'll also be launching our acquisition product, especially for smaller merchants. Not talking about the large retailers in Brazil, and this will be without the card device. So this device will now be inside, built in our -- in their cell phones. So any small merchant will profit from this, will be benefited by this and will get rid of hardware, chip or chips, so we can lower the transaction cost of credit cards.

In our report as we did before, we've always tried to add some elements of image that helps explain our model. Banco Inter's model is very disruptive, very different. For analysts and investors to better understand our business, we've been doing this. So we have -- we

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had our cash flow showing our clients now in this release. We have something new, that's our formula. An image that summarizes our corporate algorithm, our business algorithm, in other words, how we want to generate value or income to our shareholders. Not necessarily earnings in the short run, we want to generate value and that's very different. I'll explain that later. The algorithm combines growth, service growth, a wider penetration of our services, and also growth of NII or credit or loan revenue. We've been growing at this speed and delivering very positive results, because we have credit loan, that's what we know how to do. Our credit loan book lets us grow fast like tech companies. We say that this is our cash cow. This is our support, our foundation.

So in summary, these are our next deliveries. This is what we delivered in the first half of the year. So I'll turn it over to Alexandre, who will discuss the figures, financial figures, and then Elina [ph] will talk about our share performance and the volume and transactions, and then I'll go back to close the call, and then we move on to the Q&A.

Alexandre Riccio de Oliveira {BIO 20402984 <GO>}

Good morning, everyone. Thanks for participating in our sixth earnings conference call. So as Joao Vitor said, I would like to discuss our results, our earnings with this new equation for generating value. While this equation, we broke down our business in some areas, some aspects as you can see in the report. We have A, A is our major driver in this is our client or customer base growth, which is being executed with a low customer acquisition costs and consistent or sustainable growth in the mid and long run. I'll discuss these numbers later on.

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Then we have B1. B1 shows the result of this increased customer base showing service growth, with a higher volume of sales, not only with higher penetration, but also addition of new products, and we've been delivering them quarter-over-quarter products that our customers engage with and like to consume, that's B1. Now, B2, in B2, we have the goal of growing consistently, having our net profit margin growing based on two pillars with a lower cost of funding, that's one, and two, a sustainable loan book growth. And then point three. And this is about the combination of our customer base growth. A plus B1, fee income, B2, higher net financial margins. So with the three factors will be on a trajectory of generating value in the long run with more ROE and ROA. Now, I'll give you some details of our quarter, discussing growth. We had 2.54 million clients. This number exceeds 1 million are pre-IPO expectation, we're expecting to get about 2 million customers at the end of 2019, and we have 2.5 million at the end of July. We opened over 10,000 accounts per business day in June. The cost of acquisition was lower than the first quarter of 2019. So 19.53 [ph] as compared to -- what with important production. And this shows our ability to generate economies of scale, customer engaging, really positive with more mature growth, 73% activation. And most of the rates show improvement quarter-over-quarter in terms of participation, and in some of cohorts, we have three products per customer on average and we keep growing in scale and economy of scale. So globally, we had BRL210 in the second quarter compared to BRL373.5 [ph]. And this is just a fraction of the OpEx of larger banks. So that's about 10% of the OpEx of large banks. And this shows our potential to increase our profitability, as we increase the profitability and the penetration of our products within our customers -- customer base.

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In terms of services and revenue generation, we had a demand deposits of BRL1.1 billion. So this is a very important number to show the engagement of our clients. We're talking about 1,200,000 people who have been depositing into their accounts. And this is a clear indicator of their engagement and this value of 1.1 billion, is very important also for the reduction of funding costs. Another important thing is that in revenue and service we had 244,000 investors at the end of June. After the launch of PAI, we had 61,000 investors. That's what we left behind, and this is highly symbolic, it shows the resolve of a good digital experience. Our customer base grew four times and we delivered a revenue in the second quarter of 92.5 larger than PBN [ph] in the second quarter of '18. BRL5 billion was our insurance but we almost reached that. But we had also exchange -- interchange of products [ph] 2.5 million, three times larger than the first quarter of 2018 with 210,000 cards used along the second quarter. And then our generation of services, we should highlight the high diversification we've been promoting due to our ability as being a complete free digital bank. So we have this high diversification of income.

Now credit and financial margin, we had a lot of evolution funding cost within 72.2% of the CDI falling. So our funding cost surprises us every quarter, BRL4 billion in the extended loan book, a growth that did not happen in on the specific line. In other words, we grew in all sections, pay roll loans, credit cards and so on and so forth. And although this is not very high growth rate, we should highlight what Joao Vitor said, in terms of pay roll loans. We made an important change in August, last year, with our bank channel and people doubted our ability to grow. But we've been able to deliver in this quarter, for example, the best in our history in terms of payroll loans.

Well, having said that, and discussing loan growth, I'd also like to talk about our addressed market. We work in the largest credit or loan segments in Brazil, almost 2 trillion of portfolios to address and only -- we have only 0.2% of this market, about two, three years ago, people said, it was unfair. We had a high cost of funding without a customer base. Now we have all the points of this equation, they've all been addressed. This is why, we really believe in our success from now on -- with this 36% of growth year-over-year, and this represents well, if we had 1% of share in this market, we currently operate, which is aligned with our current customer base, we already have a potential of BRL17 billion in our portfolio.

In terms of profitability, our result in the quarter was BRL33 million, with 2.1% in ROE, BRL3.7, so we have BRL973 million [ph] in the Basel rate, 23.6 which shows our ability to consume capital at a consistent rate of two percentage points quarter-over-quarter.

Now, I'll turn it over to Elena, who will give you some more information

Unidentified Speaker

Good morning, everyone, and thank you for participating in the additional earnings release call. I'd also like to say that -- we have our daily volume negotiated. On July 19th was higher than BRL170 million in the three exit classes, and we have over 9,000 [ph] shareholders negotiating any our shares every day. We also have -- are planning to open another conversion window in shares, in our program, similar to the previous window. And concentrating liquidity, increasingly more concentrated on our assets. The IDI 11. And we

believe that we can now have a index like Bovespa and this would be good for all our shareholders.

So this was the main message from the management and we can now open to our Q&A session, Joao will just give you a final remark.

Joao Vitor Menin

Thank you, Elena, for your explanation, and for the support. Before we move on to our Q&A session, I'd like to summarize a few of these points. We are usually asked about guidance, but Banco Inter does not give guidance. People ask -- so what's your growth guidance? What's your profitability guidance? But then, we strongly believe in this Company that what we've been doing this work -- means having continuous committed to being highly innovative, highly creative, using technology to provide increasingly better and more accessible services to our customers. And this is our guidance. If we can deliver this -- this supersedes any economic or financial guidance, so our guidance is to be extremely ethical, and work really hard, committed to keep innovating by means of technology to provide increasingly better and more accessible services to our customers. We believe that we may reach dozens of millions of Brazilians and we're highly motivated, it's a great pleasure to be able to achieve this on a daily basis. We say that our 1300 -- 1350 employees, they're are part and parcel of this journey and of our commitment and all our employees, they have orange blood, which is our color, which, it's really reassuring. We know that we will reach our goals in high quality. So, thank you, everyone. We'll now open our Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we will now start our Q&A session. (Operator Instructions)

Sorry. The first question, Eduardo Rosman, BTG Pactual.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Good morning, everyone. Thank you for your figures, for your offering. I have two questions. First, about your customers, you're getting over 10,000 customers per business day. Maybe if you can keep this rate. You will reach 5 million clients halfway through next year, but we've seen some other players now with even a larger number of accounts. But these are payment accounts. So, you have other banks with different or competitive advantage. So have you thought about the payment accounts, considering specific customer profiles? Does that make any sense to you? Do you wish whether the change from payment accounts or payroll accounts to banking accounts? Can you tell us about the major differences between payroll or payment accounts and banking accounts?

My second question about Softbank. Have you arranged anything, will they have access to the Board? How can they add to your Company?

A - Joao Vitor Menin

Well, this is Joao Vitor. Let's first address the market and growth -- market growth, while these 10,000 accounts. We are -- well, in 3Q, the first weeks of 3Q, this figure has been even larger, even higher and even in our checking account -- full checking account, as you said. So what do I think about this? What have we been discussing about this?

I believe that one of the advantages of Banco Inter in terms of monetization and engagement is that we have a full service account, so to speak. So with PAI, our investment platform, it's been highly successful. I don't think we would be as successful if we had a payment -- had payment accounts, people are eligible to making investment with brokers -- our broker company. So payment accounts wouldn't allow them to do this. So we're talking about a 100% digital payroll accounts. You couldn't have loans. So the advantage of having a full service account is extremely high and it is not an easy task. When people say, there's no barriers for entry. Barriers, well I disagree. I believe there's many barriers when talking about a full service account with all the criterion providing with or complying with all the regulation, have to work.

We need 300 systems, every night, it's highly complex. But then we have a lot of advantages like monetization, the use of services. So, we believe this is very important. And I'd also like to stress that as we see, rather than just opening an account just for payment, why not improving that experience and having a checking account? So in the next version of our app, Super App in September, but the next week -- next week's novelty will be -- that we will provide an easier board experience. So our regulation and our technology allows this to happen.

I'll give you a simple example. For example, proof of address. It's complicated. Having easy access to your accounts or bills, for instance, to prove your address. So we can work on this and make it easier for people to open bank accounts without the need of this. So that was part one of your question.

As for Softbank, well, yes. We have invited Softbank to in our board meetings. This was something that was arranged together. It's really good to have this integration not only in the C level or management level but also at the Board level, when people say that we need to recycle our Board with people that are more disruptive and technological. So, we'll have a Board member that represents Softbank, which is the great largest technology player. That's very good for our Board. So it's not only that, but also what I think is very good in our relationship with Softbank is that we are willing to benefit from the smart money. It's not just a simple shareholder. It's a shareholder that has so much knowledge and is willing to help and we also see that they not only want to benefit from a higher value in our shares but also looking [ph] up a nice project for the bank and maybe the bank just go for other companies, so, let's say the mind behind this partnership or the rationale behind this partnership is really nice. There's a lot to harvest from now on. I think that -- that's what I -- I think, I've answered your question, I believe.

Operator

The next question comes from George Speedman, Si Bank [ph].

Q - Unidentified Participant

Thank you for the opportunity. I also have two questions. So one, and then I'll move onto two. One, when you talk about shareholder value rather than in the short run details, I think, now time value of clients should fit in. Can you describe it in further detail, how you define this figure and what is the expected value for this metric in the long run? Thank you.

A - Joao Vitor Menin

Well, thank you for your question. I'm not sure if you have two questions but you can ask your second question later. But anyway, lifetime value, as you mentioned, well, in our view, as we have increasingly more efficient processes for the financial market, for instance, we generate value. So we have a -- CAC of BRL20 for a new customer there's a full, checking -- full service checking account for the customer. And we serve this customer at 10% of the cost of a large bank. So this is a process that generates value. I believe, it generates a huge amount of value at first. It doesn't. Of course not.

We're investing in new process or in our Super App. We have 250,000 customers a month. So that's one thing. But we're also erecting or building a more efficient process, generating value. This is what we've been doing. So when we consider our target with a very low CAC, the 10% of the customer service. And also very high NII and fee income BRL600 or BRL700 a year. So when you consider the cash flow for a period of time, we'll get a lifetime value of 4000 or 400 -- 4500. [ph] That's above \$1000. So if we keep these monetization metrics with the same CAC, when we have an additional 250,000 or 300,000 customers we are generating a lot of value for our shareholders. So in the -- we'll be creating a platform of million or dozens of million customers in a few years with these figures. This is very important. Additionally, we can add other products that may either increase further this fee income. This is not easy. Of course, we can show in our income statements. This generation of value cannot be shown. But, if we go to the starting point, what was at the heart of the question.

We've been building a more -- a better process for retail banking in Brazil. And we can now comfortably say that we have built a Company of value. This is my answer to your first question. Is there a second question?

Q - Unidentified Participant

Yes. I'll ask the second question in a minute. But I'd just like to make a comment. How do you reach this and BV -- I understood this part about the cost of acquisition and the cost of service, which is slower than the larger banks. And then the addition of new customers in terms of NII and fees.

A - Joao Vitor Menin

But, there are two important factors that may not be considered in this number of 4000, 4500. And this includes tax, they are not considered provision or tax are not included. We're talking about gross figures.

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Q - Unidentified Participant

All right. That's what I needed to understand. And fine, fine. Now, my second question. We're talking about a short run results. People ask us about these, I need to understand how your minds work. So you mentioned that net profit would be a record this semester, this quarter. And the top line, it's easy to see it's been growing over 45% year-over-year. And you're still monetizing customers according to the items you've already shown us. Now, on the other hand, both in terms of expenses, they're still growing as you have more customers and then you have a 145% increase year-over-year. So your operating profit. It falls year over year? I'd like to understand this part about provision. So we had 1.9% in the second quarter of 2018, now it's 4%, 3.1% in the last quarter. Because of the -- there's demand for riskier products. So, I need to understand when and how much or how much will it de-stabilize this quarter? Have you made any other provision? Or any additional provision, I don't think you've done this, but I just need to understand all the dynamics behind this.

A - Joao Vitor Menin

Okay. Well, what's the dynamics behind our customer portfolio? First, I'd like to stress that about 12 or 18 months ago until then, we -- a 100% of our portfolio was -- had collaterals like real estate purchases and payroll, and loans and SMEs were also collateralized with large companies, but what have we added more recently that has worsened in a way our provisioning index and this is credit cards. And this is something we mention in all our conferences with all our investors. We're saying that we will be prudent in terms of the growth of this credit because it has no collateral. And then you may remember that at first I said, we wanted to make a revolution in credit with lower fees.

We have the lowest fees in around a revolving credit in Brazil, so we believe that superseding the credit card provision with 15% a month, that's not sustainable. We prefer to grow less aggressively. And we have new ways of dealing -- we're addressing this provisioning needs. So the first leverage or the first network we have now Rojeri [ph] our CIO with a completely different and more evolved experience in terms of access to loans and credit cards. So I think, we've changed with much better now and this will be felt in the next quarters, will be better at credit card.

Provisioning and then, we talk about our Super App in our marketplace as we have a take rate for sales of products that are brought in credit or loan, we will have it interchange that is consistent with the credit risk like when -- and we should say that an interchange of 1.2% is not sustainable in Brazil for credit cards. So what do banks do to strike a balance, they increase the fee for revolving credit, but in our view, it destroys the value of our customers, those who pay, the good customers, they'll be happy. So these two levers are important to decrease default in credit cards and we will grow as we feel comfortable with the risk we've been taking on our credit card portfolio. So we believe that we can optimize this with these two levers. That's what we are expecting to do in terms of credit card growth.

Q - Unidentified Participant

Thank you for your clarification, Joao.

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Operator

Our next question comes from Raphael Verdasco.

Q - Unidentified Participant

Hi, good morning, everyone. Well, I have two questions. First, can you explain more about payroll loans? So as you have 1% origination, you've been having an relevant significant growth in terms of origination. But this does not reflect directly in your portfolio. Can you explain this in details, how does this work?

Second, I'd like to discuss -- you to discuss about well, I think your outlook for individual accounts was very clear. But maybe you could explain or expand on the evolution of corporate accounts? I think, you have the intention of launching new cards in this area or if adjustments need to be made to the account?

A - Joao Vitor Menin

Okay. Thank you for your questions. Well, in terms of payroll, that's a very interesting example. When we talk about generating value and not necessarily accounting or economic results, payroll loans are a great example as we have banking correspondence. This reduces our underwriting costs and the (inaudible) as well with much more loyal customers that may consume many other products. This means generating a lot of value. Now, on the other hand, there's the cost of bringing this person in the cost of producing 100 million in payroll loans, which we did last month.

Well, we'll have this for seven, eight years. That's the average term payroll loan services. So even if we don't deliver with -- as this grows, if we don't without intermediaries, if we don't deliver profit in the subsequent quarter, we're still generating a lot of value. So we look at our balance sheet and what we have been acquired in terms of expenses for correspondence, it's almost zero. It will be like this irrespective of the central banks' resolutions, we don't have expenses with correspondence, so it's all anticipated. Now, this healthy customer that won't go from place to place soon knock on every door that will effectively generate NII for seven years and consume other products. Of course, they will generate a lot of value, but not necessarily on -- in the subsequent quarter. This is about payroll loans. But with a portfolio of a lot of added value. In terms of corporate accounts, well, what have we done? Our strategy has been focusing on individual accounts. That's what we -- where we in order to gain market share.

So with our individual account products after the launch of our investment platform, PAI, have now with our insurance services, with Wiz and then the Super App. While these customers are really well served, a 100% of what any individual can have. So maybe in six months or 12 months, we started considering what else can we do to improve the experience of our corporate customers? And this is something we have been discussing. So we have a team that's now exclusively dedicated to improve our app for corporate accounts. We believe that our corporate accounts will run in apps.

We're not talking about large companies with a finance department, we focus on small company or corporate accounts and we're trying to improve our app to provide better

services and also launching new services to them because we have over 400 million of other bank agencies that transfer to these small merchants. So in the next quarters, we believe changes or improvement in terms of service quality and also service offerings and this -- this will happen and we'll have more corporate account holders as a result and this will mean monetization.

So in conclusion, if individual account holders had a hard life of being poorly served and being charged a lot of money, now a small merchant is even in worse -- in a worse situation. So this new situation or conditions will be better.

A - Unidentified Speaker

Thank you. Joao.

Operator

(Operator Instructions) Our next question comes from webcast.

A - Unidentified Speaker

What do you imagine changes will happen in your Super App? Your Super App, it's already seen as highly complete, so what are the benefits of the Super App for the account holders or your customers?

A - Joao Vitor Menin

I don't know who asked this, but I thank you anyway. On Super App, well, in order to have a really nice Super App, you need some elements. High data quality as we want to be a 100% digital and also on smartphones and they have to be recurrent. We have a -- an average of one log in more than retail banking, and we need to be -- to have loans or credit available and also the possibility of making payments. So this makes us really competitive in offering Super App for selling non-financial services as well. So those who already like the bank, we want them to enjoy their app experience.

Why not buy your ticket, air ticket, for instance, through Banco Inter or a movie ticket, you can buy it through our bank. We want people to experience our platform increasingly more so with these four elements. It's only natural that people consume products and services that are non-financial services through our Super App, really excited about this. By the way, we have a dedicated team, high caliber team, (inaudible) our CEO, Marcela as well is the CEO of inter marketplace in addition to our technology team that is already working hard on the project. So I believe this will be a very interesting experience for our customers again with an efficient process that generates value, as we've always done, so the cash back is a practical example of returning that efficiency to our customers. So this is what we really believe, we are really excited about this. Let's see how things will evolve in the next quarters or years, I think, this will be highly interesting and highly transformational for the Company as our digital account in 2016.

Operator

(Operator Instructions) We now close our Q&A session. We would now like to turn it over to Mr. Joao Vitor Menin for his final remarks.

Okay, you may proceed.

A - Joao Vitor Menin

Thank you. I hope, I can see you soon in about three months time for our earnings release call for the third quarter. I hope, I have a lot of nice things to share, so thank you and have a nice day.

Operator

Banco Inter's conference call has now closed. Thank you, everyone, for participating. Have a nice day.

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