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Q2 2021 Earnings Call

Company Participants

- Carlos Firetti, Business Controller and Market Relations Director
- Leandro Miranda, Executive Deputy Officer and Investor Relations Officer
- Octavio de Lazari Jr., Chief Executive Officer & Member of Board of Executive Officers

Other Participants

- Mario Pierry

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. We would like to welcome everyone to the Bradesco's Second Quarter 2021 Earnings Conference Call. This call is being broadcasted simultaneously through the internet in the Investor Relations website, bradescori.com.br/en. In that address, you can also find the presentation available for download. We affirm that all participants will only be able to listen to the conference call during the company's presentation. After the presentation, there will be a question-and-answer session when further instructions will be given. (Operator Instructions).

Before proceeding, let me mention that forward-looking statements are based on beliefs and assumptions of the Banco Bradesco's management and on information currently available to the company. They involve risks, uncertainties and assumptions because they relate to future events and therefore, depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions, and other operating factors could also affect the future results of Banco Bradesco and could cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Mr.Carlos Firetti, Business Controller and Market Relations Director.

Carlos Firetti {BIO 2489005 <GO>}

Hi, everyone. Welcome to our conference call for discussions of our second quarter 2021 results. We have today with us here in our headquarters, our CEO, Octavio de Lazari, Jr.; our Executive Vice President, Andre Cano; our Executive Director and IRO, Leandro Miranda; our CFO, Oswaldo Fernandes; the Bradesco Seguros CEO, Ivan Gontijo; and Banco Next Chief Executive Officer, Renato Ejnisman.

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Now I turn the floor to Leandro.

Leandro Miranda {BIO 21476649 <GO>}

Thank you, Firetti. Good morning, everyone. Thank you for your interest and for joining us on our second Q earnings conference call. This quarter, we saw a new surge in the pandemic, which unfortunately affected a significant number of Brazilians. However, there was also a great acceleration in vaccinations, which is the only real solution for the COVID-19. The current pace is good, and it shall accelerate even further. Over the coming months, this should help Brazil achieve the benefit seen in the countries that are more advanced in vaccination phase.

We see continued recovery on the current economic theories, even with the spike in COVID case in the beginning of the year and especially now with vaccinations ramping up. We foresee a growth of 5.2% in the Brazilian economy in 2021. Formal employment is rapidly rising, supporting loan growth and keeping delinquency ratios at historically low levels. Fiscal risks have decreased with GDP growth, leading to a positive surprise in debt-to-GDP ratio, and thereby enabling an appreciation of the real.

On Page 3, we begin a discussion on our numbers. Our income in the quarter was BRL6.3 billion, with the accumulated return reaching 18.2% over six months. The loan portfolio expanded 3% in comparison to the previous quarter and above 10% year-on-year. The Tier 1 ratio reached 14.1%, an increase of 0.5 bps Q-on-Q and 1.6 bps year-on-year, which indicates a very comfortable capital level. So far, this year, we have already distributed BRL6 billion in the form of interest on shareholders' equity. This brought our payout to 52%.

We feel that our second quarter results had the good level, driven by a robust performance in banking activity. The insurance income was adversely impacted by the increase in health and life insurance claims due to the impact from new spikes in the pandemic and a lower financial income due to variations in marketing indices. The fact that we were able to deliver a strong consolidated income despite the hit taken from insurance activities demonstrate the strength of our balance sheet and our organization's ability to diversify our revenue streams.

Moving now to Slide 4. We present our income statement. As we mentioned before, the lower quarterly income primarily reflects the impact on the insurance business, which was heavily affected by the claims related to COVID-19 despite the evolution of 20% in revenue year-on-year. Looking just at the income from the banking structure, the growth in the quarter was up 16% compared to the first Q. In later comparison, the income grows 125% as the second Q was the most affected by the pandemic. It's worth noting that the banking structure's income in the second Q was 22% higher than the second Q '19.

The total NII was up 1% in the quarter and down in yearly comparison because the market NII was rather high in the second Q '20, thanks to the robust market with COVID activities. ALL expenses came at a very good level, posting a reduction of 10.7% Q-on-Q. This comes from the positive performance in the funds and our loan models. We would like to

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point out the sharp improvement in costs and the surge in the COVID increase. Finally, when we compare our operation this half year with the first six months we have in 2019, it's possible to notice that we have had significant evolution and that we are expanding.

Total revenues are up 6% and reflects the growth in the portfolio and customer base, more than absorbing the last (inaudible). Expenses fell 7.3% even with the high inflation accumulated in this period. And as a consequence, the efficiency ratio reached 45.7%, an improvement of 3.7 percentage points.

We will now take a look at Slide 5. Our funding activities, as you may see, continued to perform well. Funds from clients grew 4.5% in the annual comparison, particularly demand deposits and savings, the latter being an important source of funding for our mortgage loan operations.

On Slide 6, we'll talk about the expanded portfolio, which grew 9.9% in 12 months. We posted a sharp 21% high in individuals and 28.7% in SMEs. For large companies, the annual comparison was somewhat hampered by the solid growth of working capital lines at the start of the pandemic and greater access to the capital markets at the starting. Some lines reported the attractive levels of growth over 12 months. In real estate funding, it grew by 40%. This performance reflects improvements in our contracting process and the strength of our origination channels, in which I would like to highlight our digital journey that originated around 1,700 transactions in the first semester of 2021, four times higher than last year, therefore, a channel that is increasingly gaining share in our loans origination.

Payroll-deductible loans grew 19.8%, with origination of contracts on our own terms. Agricultural loans rose 18.2%, an increase of BRL3.1 billion for companies and BRL1.2 billion for individuals, reflecting the correlations we have with farmers through our regional agricultural platforms which we have reinforced with agricultural engineers, along with the distribution of our branch network, which is (inaudible) major agriculture municipalities. The growth of 28.7% year-on-year reflects the reposition we made in our business results structure, in which we (inaudible) the number of coordinators and also added 600 relationship managers.

We also reviewed the small entrepreneur origination journey. We will have more news in the second half.

Finally, I'd like to highlight that the origination of loans to individuals, which has been already enjoying steady growth progressed even further and now is 40% higher compared to the same quarter of the previous year. In this quarter, with the recovery of the economy, the origination of companies grew by around 25%.

Turning now to Slide 7. Our expanded ALL expenses totaled BRL3.5 billion in the quarter, representing 1.9% of the portfolio. The level was consistent with our guidance. The reduction in cost of risk is a consequence of the positive performance in delinquency ratios and the growth in normal risk transactions over the last few quarters, such as we have state financing payroll deductible loans (inaudible).

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The 90-day coverage ratio remains at rather high levels and is expected to continue above pre-pandemic levels up to the end of this year. The coverage ratio, including the renegotiated portfolio, remained virtually stable.

Turning now to Slide 8. We see that the delinquencies are remaining under control, in line with our expectations. The 90-day ratio remained stable with a 10 bps improvement in individual segment. The 15- to 90-day ratio showed signs of improvement seen in all segments. We believe that the delinquency ratios are expected to convert to near pre-pandemic levels by early 2022. This positive performance can be explained by an active portfolio management. The progress of our loan models and (inaudible) application as well as renegotiations that are extended on the clients. I would like to highlight that the NPL creation this quarter is at the same level of 2019.

Moving to Slide 9. The extended portfolio continued to improve falling 36%[ph] year-on-year. From a balance of BRL41.3 billion, only BRL3.5 billion are in arrears for over 30 days. The possibility of activation remained available to clients in the second quarter, but the demand was low.

Coming to Slide 10. You can see that our renegotiated portfolio declined by BRL900 million in the second Q this year, after holding a stable position in the first Q. This shows our trend towards more normal loan conditions. We maintained a high level of provisions, maybe the highest compared to our peers, equivalent to 62% of the portfolio. The delinquency ratios in the renegotiated portfolio continued to be stable over the quarter but are expected to climb by the end of the year, returning to pre-pandemic levels.

Turning now to Slide 11. The total NII grew 1% over the quarter. Year-on-year, there was a drop of 5.7%, thanks to the strong market NII in the second quarter of the previous year. The quarterly growth in the client NII is mainly driven by the expansion in individuals portfolio, mainly in personal loans, credit cards and payroll deductible loans, which more than offset the slowdown in spreads motivated by market dynamics. We expect spreads to start rise. Indeed, it might even improve during the second half due to the covenant improvements.

We now turn to Slide 12. We posted a strong performance in fees. We are seeing an intense growth in the volumes transacted in both debt and credit cards, reflecting a recovered economy. For checking accounts, we were able to recover the level of revenues from our quarter of '19 correspondence due to a resumption in commercial activity. Revenues were also positively impacted by an annual growth of more than 1.7 million clients, offsetting reduction in debt and broker revenues.

In asset management, the growth over the quarter came out of the strategy to diversify into new products that have a higher added value. In addition, we experienced growth in our net funding, both in our own products as well as on third parties. This comes as a result of the work performed by our team of investment specialists, contributing to a net funding of BRL17 billion in the first half of 2021 and also by higher revenues originated from third-party funds.

We also highlight the strong performance in the income from consortium investment bank, benefit from the favorable market trend.

Operating expenses now on Slide 13. As you can see, our total costs fell by 4.4% over six months. The comparison between the quarter and the previous year is impaired by the poor base of comparison as a number of expenses were not carried out due to the pandemic. Personnel expenses were primarily impacted by higher provisions for profit sharing and (inaudible) expense, compared to the previous year, given the 60% higher net income this year. The decline in the administrative expenses for the half year reflects our stringent cost control measures and actions to optimize our cost of serving which more than offset the high inflation accumulated over the 12 months and (inaudible) 8.3% and GPM 35.8%.

Turning now to Slide 14. Our insurance operations at Bradesco grew 20% in revenues, and resilience in (inaudible) of income, which was BRL2.3 billion despite the weighted level of claims due to the events related to the pandemic. On this slide, we highlight the COVID-19 impact in our insurance operations, with costs reaching BRL1.8 billion in the second quarter '21 and BRL3 billion in the first half, totaling around BRL4.8 billion since the beginning of the pandemic. The financial income in the second Q also was affected by the behavior of the ratios, which had an impact on the performance of financial investments as a whole. This scenario is temporary. It already shows improvement as a consequence of the vaccination, but we decided to revise our insurance guidance as well as we'll give detail further on.

Slide 15 gives an overview of weekly events related to the pandemic in our healthcare business. Here, we show the curves with the volumes of PCR tests that have been administered as well as hospitalizations for COVID holders during the same period. Since the onset of the pandemic, Bradesco (inaudible) ensuring clients took more than BRL1.3 million -- 1.3 million PCR exams and approximately 78,000 ended up hospitalized. As you can see, this graph is a good indicator for hospitalization levels, and these charts allow us to expect reduction in the short future due to the recent weak strand, although still high level.

We now move on to Slide 16. As you can see, our capital and liquidity ratios. Our Tier 1 capital ratio finished the quarter at 14.1%. And the common equity stood at 13.1%, which was an increase of 50 bps compared to the previous quarter and 160 bps compared to June 2020. The ratio is well above the regulatory means in a fairly comfortable level.

Moving now to Slide 17. We provide data that demonstrate the growth in the use of our digital channels. This year, 98% of transactions are already done by clients using our various channels (inaudible) and intuitive journeys, and an ongoing evolution towards transitioning to digital with outperformance on the branch. The most significant transaction of items are now seen in the mobile channel. The number of financial results within the first six months of this year reached BRL600 million, which is 1% higher than the previous year. We also saw a record number of accounts opened for both individuals and companies. (inaudible) volumes that are about twice as high as last year. The volume of loans coming from digital channels over the period amounted to BRL31 billion, 21% higher than last year. Growth in digital segments came to 54%.

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The number of credit card requests to digital channels grew 270%. And this year, we issued 3.9 million new cards. For the insurance company, we managed to sell 1 million products through digital channels in the first half of 2021, which represents revenues of BRL700 million, an annual increase of 80% compared to the same period last year.

We now move on to Slide 18, where you can see the evolution of our payments. The push we have been giving to Pix from acquiring (inaudible) journey with financial inclusion and contributing to improved volume of transactions. Pix is responsible for over 50% of the increasing transactions. We witnessed a digitization of minor transactions, given the fact that around 40% of the volume in Pix transactions are below BRL50. At the same (inaudible) only processed checks and ATM withdrawals have decreased in quantity, which contributes to a reduction in our expenses.

Turning now to Slide 19. In addition to continually improving our channels, we have also made investments in BIA, our artificial intelligence that simplifies our clients' lives by providing increasingly pleasant experience. I would like to point out that we are pioneers in the use of artificial intelligence in Brazil. In this first half of the year, digital interaction grew 43%, totaling 275 million interactions with clients, in which 83 million of these interactions were through WhatsApp.

I'm pleased to share with you that Bradesco received for the second consecutive year, the award of Most Innovative Bank in Latin America, an award recognized by the banker magazine, reflecting all the investment and focus we have placed on innovation.

Turning now to Slide 20. We can see Agora, next and Bitz. Our digital business, as you could see throughout the presentation, posted a strong performance. Agora saw nearly 50% growth over 12 months in both the number of clients and in terms of volume under custody. Agora is getting more and more important in funding for us as well, as you can see that there is a increase of 81% in that funding. next is expected to continue to show robust both growth in the second half, thanks to the Member Get Member program and partnerships. The sign-up process has been in progress, and 70% of our accounts are opened within 24 hours; next has also incorporated ShopFacil that now includes a new source of revenue from nonfinancial business. And finally, Bitz, the digital wallet that we introduced last September, has already surpassed 1 million accounts.

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Turning now to Slide 21. We would like to point out that we are the first financial institution in Brazil to announce our goal to achieve a balance between greenhouse gas emission by our clients and invested companies, reaching what is known as net zero. This is an extension of our climate strategy. 15 years ago, Bradesco was one of the first to measure the amount of carbon generated at group's own operations. In 2019, we have neutralized 100% of these emissions.

In 2020, we were also the first financial institution in Brazil to join PCAF, the Partnership for Carbon Accounting Financials. We have arrived at a new level of climate management, and we'd like to play a leading role in this transition in the country, engaging and supporting our clients for better business while promoting a more efficient, clean and climate resilient economy.

Moving now to Page 22. Concerning our guidance, we considered expansion of well-balanced drivers when the year began, and we maintained expectations for all lines with the exception of insurance due to the change in the pandemic of COVID-19. We believe that we see growth above the center of the range for the loan portfolio as well as for fees and in the center for client NII. At the bottom, fortunately, costs primarily due to the expected impacts from the collective bargaining agreement for bank employees as the inflation accelerated sharply in the first half. In the center of the guidance for ALL expenses. The insurance guidance was reviewed downwards, and we now anticipate a drop from 15% to 20% as a consequence of the drops described earlier today.

Finally, I would like to thank you so much for making the time to be with us, and now we are going to proceed with the questions-and-answer section.

Questions And Answers

Operator

(Question And Answer)

(Operator Instructions) Our first question is coming from Mario Pierry of Bank of America. Mario, your line is open. You may proceed.

Q - Mario Pierry {BIO 1505554 <GO>}

Hi, everybody. Good afternoon. I have two questions. First, related to your insurance operations and especially in your guidance that you have given for the year. During (inaudible) in last year, you're basically guiding for results from insurance of about BRL10 billion in 2021, which means an average rate of only BRL2.6 billion in the third and fourth quarter. But when we look back over the last four quarters, your results in insurance were averaging almost BRL3.1 billion, even there's you've already included the expenses related to COVID in the first quarter. So I was wondering, why do you expect your run rate to remain below the last four quarters, especially considering a higher rate realization to be positive for your financial results? So that's my first question.

Second question is related to your operating expenses. You are very close to the top of the guidance here, expenses of 4%. However, we see some significant headwinds already in the second half of the year, especially related to salary negotiations. Talk a little bit about where things are in regards to annual salary negotiations and how can you offset the headwinds in the second half of the year, especially when you've already closed about 1,000 branches over the last (inaudible), which is almost 25% of the branch network. Is there more room for you to reduce branches? Or the efficiency needs to then turn somewhere else? Thank you.

A - Leandro Miranda {BIO 21476649 <GO>}

Okay. I'm going to ask Mario to help me with the two questions if I'm not able to answer all of those two to you, Mario, because the sound was not that clear. As far as the insurance, the first question is related to the guidance for insurance, right? So basically,

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the way we see the big aspects[ph] and therefore, we shall have better quarters from now on, especially in the fourth quarter, as we continue to grow in terms of premiums that our revenues. And especially in light the number of debt has also back in the (inaudible) part, we expect that this will come along more in line with the previous years. But of course, this can occur gradually, and it also depends on if we see a new mutation in the year, how it's going to evolve in terms of vaccination.

Regarding to the operating expenses, these are rates contemplates over the employees or personnel adjustment that we shall have in the second semester. We believe that we are going to continue to reduce expenses overall despite of this increase in salaries. Because basically, as of what I have spoken out earlier, we continue to close branches, and we continue to transform those branches into point of sales or business units. We continue to reduce our administrative expenses as well. So we understand that we are going to be able to keep the lower part on the balance.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Sorry about the quality of the sound. It's a little bit hard for us to hear as well. But so just to go back on insurance, right? If I look at your first quarter results, the insurance had like BRL3.1 billion. And you already have very elevated costs related to COVID. So -- but if we think about it, your financial results should improve, anything if for COVID, expenses remain elevated in line with the first quarter numbers. I was just wondering why we shouldn't able to average BRL3 billion per quarter in the second half of the year.

A - Leandro Miranda {BIO 21476649 <GO>}

Yes. Mario, basically, we are assuming in the guidance that we continue in the path to normalization in the second half. For sure, we have with a disclaimer that, as you know, there is a lot of uncertainties on how it's going to progress. But our view is in this path to normalization, the third quarter is going to be better than the third quarter that probably got a lot of the cost of claims that came from the peak, but it's still not a normal quarter because there are a few costs that should be impacting it.

We expect a gradual convergence of the inflation index that impacted the results, so reducing the negative impact in our financial results, but that's also something that we are cautious on forecast. So I think you should take our guidance as one that takes a view of that we are going to a normalization, but not a total normalization from the beginning of the third quarter. It's something that will happen with some graduality.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you. And just to follow up on the insurance also. Your ability to increase prices going forward for premiums and for your plans, how do you think about that going into next year?

A - Leandro Miranda {BIO 21476649 <GO>}

Well, I think we are going to have a couple of benefits there. The first one is that with the improvement of the economy, pretty much companies have Bradesco's (inaudible) a premium plan for their employees. So we have seen that we have a very high correlation

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in sales of our plans as the economy is getting better. That's the first one. The second one is that we have the plan that really affects the customers. So the plan that you have seen here hardly ever would be accepted in other insurance companies. That's the reason why more and more people are buying the plans from us, so it's another of incentive in the clients. And therefore, we shall be keeping on the increasing revenues. But of course, the market is going to depend on the price. There is no way that we can circumvent that, but the quality is being well appreciated by the markets.

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A - Octavio de Lazari Jr. {BIO 17539074 <GO>}

In addition, we are presenting a very important growth through digital channels. In the first half alone, we have a little bit more than 1 million insurance items that were acquired digitally. We see that trend continue. Also, as Leandro pointed, we see the perception of value of insurance for customers increasing and given the uncertainty we have seen and the risks perceived during the COVID crisis. So we see a solid demand for life insurance and on the other side health insurance. We have a premium plan. So I think even if the economy has not really fully recovered, this -- the kind of premium growth we are experiencing already starting to show an encouraging trend.

A - Leandro Miranda {BIO 21476649 <GO>}

Well, it's heartening to see how the digital channels are improving the sales. Octavio[ph] has a very good point there. And we are using digital channels, not only the bank but in all of our platforms. Agora is going to start to sell also -- to offer insurance products to our clients. So more and more, we are attracting the different pools of clients that we have in order to have a base of more than 7 million clients through digital channels, but from different platforms. So we can see the best from them.

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Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you very much.

A - Leandro Miranda {BIO 21476649 <GO>}

Thank you, Mario.

A - Carlos Firetti {BIO 2489005 <GO>}

Okay. Thank you, everyone for being with us. Thank you very much everyone for making the time to be with us. Have a great day.

Operator

That does conclude Bradesco's conference call for today. Thank you very much for your participation. Have a good day.

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