Q1 2018 Earnings Call

Company Participants

- Bernardo de Azevedo Silva Rothe, Vice President of Investor Relations and Financial Management
- Daniel Alves Maria, Head of Investor Relations

Other Participants

- Carlos Macedo, Analyst
- Jason Mollin, Analyst
- Natalia Corfield, Analyst
- Olavo Arthuzo, Analyst

Presentation

Operator

Good morning, everyone, and thank you for waiting. Welcome to Banco do Brasil First Quarter 2018 Earnings Conference Call. This event's being recorded and all participants will be in a listen-only mode during the company presentation. After this, there will be a question-and-answer session, at that time further instructions will be given. (Operator Instructions)

This conference call is also being broadcasted live via webcast and 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 +5511-2188-0400 in English and Portuguese. To access the replay, you must ask the operator to listen to BB's conference call. Your identification will be required. Participants may view the slides in any order they.

Before proceeding, let me mention that this presentation may include references 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 systems. Banco do Brasil is not responsible for updating any estimate in this presentation.

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

Daniel Alves Maria {BIO 17030121 <GO>}

Good morning, everyone. Thank you for attending our first quarter 2018 financial results conference call. I'd like to start the presentation slide four. On the left, we have the highlights of the first Q '18 results. The adjusted net income grew 20.3% over the first Q '17, driven by a 5.4% growth in income, the improvement in credit quality with a decrease of 25 basis points in the NPL ratio over 90 days, which resulted in a decrease of 26.3% in the credit -- provisions expenses and a reduction of 0.2% in the administrative expenses.

On slide five we bring the track record of some market ratios of Banco do Brasil, and we have also added to the series, the average it makes by analysts for 2018 and 2019 to those metrics. These estimates are prior to the new payout announcement made yesterday. Adjusted earnings per share reached BRL1.09 in the first Q '18, the dividend yield was 2.72%, the price/earnings ratio reached 10.10%, and the price/book value ratio was 1.13 in the first Q '18.

On slide six we have the information of the net income. On the graph at the top of the page we present the NII for the first quarter 2018, that reached 12 billion. The net financial margin which comes after the deduction of BRL4.2 billion of allowance for loan losses expenses, reached 7.7 billion. The fee income reached 6.5 billion, and the administrative expenses were 7.8 billion, resulting in an adjusted net income of 3 billion with 13.2 ROE.

On slide seven we show the main components of the net income. The NII net of recovery reduced 11.5% over the first Q '17. Such outcome can be explained by a combination of events, reduction of the average balance mainly with the very small and small companies, sale of a corporate bond that was under judicial recovery resulting in the recognition of a position that previously was market-to-market, affecting the treasury income. Note that in the first Q '17 the new revolving credit card regulation was not fully required, distorting the comparison with the first Q '18.

Although the funding expenses had strongly decreased, the reduction in the financial costs were not sufficient to offset the impact in the revenues. We expected this dynamic in margins and we are confident that in the upcoming quarters margins, we improve converging to the guidance. On the fee income we observed an increase of 5.4% compared to the first Q '17. We highlight checking accounts fee going up 9.1% and asset management fees up 9.7%. Administrative expenses decreased 0.2% compared to the first Q '17 and 5.8% over the fourth Q '17. Driven by a better credit quality in the loan portfolio ALL expenses reduced, reaching 5.4 billion.

On slide eight we have the expanded view of the loan portfolio and the credit quality indicators. On March 18, the loan portfolio reached BRL675.6 billion, reduction of 0.8% over December '17, explained mostly by the decrease in the company's portfolio. The NPL ratio over 90 days has decreased for the third quarter in a row, reaching 3.65% in March. Disregarding a specific case, the NPL over 90 days would be 3.22%, returning to the levels below the industry.

The NPL formation reached a nominal value of 6.3 billion, resulting in an indicator of new NPL over the loan portfolio of 0.99%. The coverage ratio was stable at 153.6% and the cost of risk attained 3.8%.

On slide nine we show the organic individual portfolio. This portfolio was stable compared to December, improved 3% in 12 months, reaching BRL177.2 billion. 77% of the individual portfolio is comprised of payroll loans, mortgage, salary loans and auto loans. The NPL over 90 days reached 3.49%, explained by the seasonality of the first quarter of each year. The NPL formation had an occasional increase in the mortgage portfolio, worsened by the seasonality of the first quarter as a common. The coverage ratio was 168%, while the ALL expenses were BRL1.8 billion. It is important to highlight that the 2017 vintage of the individuals portfolio is the best ever. 2018 vintage should follow this behavior.

On slide 10 we present the company's portfolio in the expanded view. In March, loans to companies reached BRL263.2 billion, a reduction of 6.3% year-on-year and 1.6% compared to December. This drop was concentrated in the very small and small companies segment. The NPL over 90 days reached 5.76% and the lowest since the fourth quarter of 2016. Disregarding a specific case, this ratio would be 4.54%. The new NPL reached the nominal value of BRL2.8 billion, with the new NPL over the loan portfolio ratio of 1.25%. The coverage ratio attained 139.7%. With a better credit quality of the portfolio ALL expenses in this quarter reinforces the downward trend, reaching BRL2.5 billion.

On slide 11 we have the agribusiness loan portfolio. This portfolio grew by 1.5% on December '17 and 2.6% year-on-year, reaching BRL184.7 billion. The NPL plus 90 days was 1.85%. The decrease in meat and milk prices along 2017 affected producers, and drove the increase in the NPL. In the first Q 2018, this group of customers still explains the increase in the NPL. The coverage ratio reached 156.7% and the ALL expenses remained stable.

On slide 12, in the blue line, we bring NIM, which decreased to 3.84% in this quarter. We also presented NIM with recovered credit in the dotted blue line. Comparing the first Q '18 to the fourth Q '17, the reduction of NIM can be explained by increases in the liquid assets associated with a decrease in the loan portfolio. Other factor was the fewer calendar days that impacted the accrual of interest income in the loan portfolio. At the bottom, we simulate NIM without those effects we've just mentioned. In this scenario, the NIM would be at 4.09%. With the NII convergence to the guidance along the year, we expect an improvement at NIM in the upcoming quarters.

The spread of the individual portfolio improved to 16.47% over 16.29% in the previous quarters. In the agribusiness, the spread decreased from 4.79% to 4.71%, in line with the track records, while the companies' spread dropped to 4.66%, mainly impacted by the reduction in the exposure to the segment of very small and small companies.

On (Technical Difficulty) the total ratio reached 18.4%. The Common Equity Tier 1 was 9.76%. We reinforce our target to maintain at least 11% of CET1 in January 2022, building up capital organically, even assuming the new payout ratio.

And in the presentation we discuss the guidance. Adjusted net income was BRL3 billion, which shows convergence to the guidance analyzing quarter results. The NII reduced 11.5% and our projections reinforce that we move towards the branch along the year. The loan portfolio decreased 1.3% as a consequence of this 7.3% reduction in the company's portfolio, a 2.9% increase in the individuals book and 6.4% in the rural loans, within the guidance. The allowance for loan losses reached 4.2% -- BRL4.2 billion and the fee income grew by 5.4%, both inside the guidance range. Administrative expenses stayed below the guidance, decreasing by 0.2%.

This concludes today's presentation and we can go to Q&A session. Thank you very much.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Mr. Carlos Macedo from Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Hi. Good morning, gentlemen. I have a couple of questions actually. The first question is on your loan growth, because in the quarter still not particularly strong. But I wanted to ask about your origination levels. Itau, earlier in their conference call, talked about origination, closing into where they were originating back in 2014, particularly for the SME and the consumer books, not as much for the corporate. Can you talk a little about that, where origination levels relative to historic levels and when you expect it to get closer?

Second question, could you talk a little bit about your Ag book? Did you see in the quarter there was a pretty substantial increase in the acceleration in the non-equalizable loan book, whereas the equalizable loan book did not really increase that much. Could you talk a little bit about that? Thank you.

A - Daniel Alves Maria {BIO 17030121 <GO>}

Hi, Carlos. This is Daniel Maria speaking. Thank you for the question. First of all, about the origination, we have here in slide, on page 23, that we showed the levels of disbursements that we are observing, just an observation piece. Slide is prepared in a way that is an index, then it's compared to the first quarter '16. Then, although our portfolio shows some decrease and this is due to the characteristics of the new originations that we are doing with the shorter term, the level of disbursements is increasing and we show here in this slide, and is consistently growing, yeah. For that reason, we believe that we are going to -- we are in this process of changing the mix of the portfolio.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thank you. Could you -- just going back, could you talk a little about the different portfolios within that -- the individuals and the corporate, just to get an idea of SMEs given that it does represent a very important part of your book that's been declining over time?

A - Daniel Alves Maria {BIO 17030121 <GO>}

Yes, for sure. In the case of medium-sized companies, as we mentioned, there is two effects for the decline for this portion in the portfolio. First of all, we are in the process of writing off some of the -- or this segment is more exposed to the cycles. And we are in the process of writing off some of the loans. I would say that we are in the end of -- at the end of this cycle, yeah. And when we look at the net disbursement for this segment, we start to see positive numbers and mainly for working capital. For the total lines of credit for medium-sized companies, we still see some negative disbursement, but we see the inflection point happening in this first half of the year.

And just an observation, when I refer to medium-sized company, I want -- I meant the small and very small companies, because the way we disclose, we are referring to companies up to 25 million in revenues, yeah. The medium-sized companies they are together with corporates and they are behaving well in terms -- stable in terms of disbursement.

And coming back to your question about agribusiness. In the case of agribusiness, we have the pressure in terms of NPLs is a combination of facts, yeah, but the main or the most important aspect is the segment of livestock, I'm referring to cattle and milk, yeah, milk production. We had the -- the prices dropped and this put pressure on the margins of the producers and certainly reflected in some NPLs. This cycle of this production is longer compared to the other products. For that reason, this is remaining in our NPLs. There are efforts that the network is doing to change these trends, yeah, and we expect to come to a normal cycle, yeah.

Thirdly, and there is another aspect that is important to remind is usually the crop or the harvest happens -- or the end of the harvest happens in the first quarter of the year and sometimes you have some delays or past due that will be normalized in the April. But we expect along the year to come to normal cycle of NPLs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you. But as far as the equalizable versus the non-equalizable loans that really drove growth with the non-equalizable loan this quarter?

A - Daniel Alves Maria {BIO 17030121 <GO>}

Carlos, just a clarification, are you referring to the lines of credit equalizable or -- what's your question? Can you clarify?

Q - Carlos Macedo {BIO 15158925 <GO>}

Sure. So in the quarter, typically the first quarter is a weak quarter with growth and I think that's something that was seasonal. But this quarter you actually grew fairly decently. And if you look at the data, it shows that it was mainly on the back of non-equalizable loans, which typically -- which is one of the reasons why equalization revenues weren't as high as loan growth was for agro. I'm just wondering what led to that and what should we expect going forward.

A - Bernardo de Azevedo Silva Rothe {BIO 18059993 <GO>}

Hi, Macedo. This is Bernardo speaking. Just to clarify, with this very low interest rate that we are leaving [ph] nowadays, we have been disbursing with more lines using demand deposits and so on that does not carry the equalization. And that type of transactions, they are very good in terms of spread for us. So that's the reason, just because of the level of interest rates in the market right now. So some of the lines that carry a equalization, they are pretty much in line with the lines that have no equalization at all at this point in time, given the way the market's behaving in terms of interest rates.

Q - Carlos Macedo {BIO 15158925 <GO>}

Fantastic. Thank you, Bernardo.

Operator

Our next question comes from Mr. Olavo Arthuzo from Santander.

Q - Olavo Arthuzo {BIO 19964942 <GO>}

Hi. Good morning, everybody. Just wanted to get a better understanding on the mindset or view about the payout ratio from now on. We understand that every year you discuss it, how much would be paid, so it could be change again next year. But given the operating trend the banking's presenting, I believe that these levels should prevail. But now, before this announcement you guided the market to a capital level of 11% by 2022. And when reached that goal, you would discuss again the use of the capital of the Bank, and one of the alternatives could be the increase of the payout. So my question is, given the flag raised with this announcement of the payout and the potential return for a 40% in the payout already this year, is it possible to imagine that the Bank once reached this 11% target, could raise the payout even more above 40%? And thank you.

A - Bernardo de Azevedo Silva Rothe {BIO 18059993 <GO>}

Thank you, Olavo, for your question. Bernardo speaking. Well, the rationale of the payout is very simple; we reach our target for next year with some margin in this quarter, right. So and with keep growing the capital base as we've been growing for the last three years, it's pretty much under control the 11% target as a minimum for 2022. So there is no reason for us to reach that 11% target way before 2022. So we have room to start to increase the payout and start paying more and increase the dividend yield of the Bank at this point in time, given the comfortable situation that we have in our capital base.

Just to remind everyone, the minimal level in Brazil is 8%, it's going to be 8% next year, right. The Central Bank did not activate the countercyclical buffer. So 9.5 already give us 1.5 buffer. And our projections indicate that even with an increasing payout, we are going to be over our own minimum target and we should reach the 11% with very -- with comfort, we can even reach that before 2022. So that's the rationale. And as we decrease when we need to retain more earnings, now that we are in a very good track, we increase the payout again.

In relation to what we are going to do when we have excess capital, right, over the 11% and so, if there is room to increase payout that was possible, so we can grow over 40% if that's the case when the time comes to have the decision. So there are other ways of dealing with the excess capital, but of course, the payout is one of them. I believe that they want more efficient for investors, but we have other options as well.

Q - Olavo Arthuzo {BIO 19964942 <GO>}

Okay. That was very helpful. Thank you, Bernardo.

Operator

(Operator Instructions) Our next question comes from Mr. Jason Mollin from Scotiabank.

Q - Jason Mollin {BIO 1888181 <GO>}

Hello. My first question is regarding the net interest income. And versus your guidance, you showed a weaker number in terms of growth versus what you're expecting for the full year, and you talked about the confidence that you can meet that. If you can, describe a little bit of what's driving that. It looks like to me the first quarter of last year was quite strong as a base effect. So what should we be assuming here going forward for the rest of the year to be able to show this reduction in negative growth?

And my second question is -- well, why don't I ask after the first question.

A - Bernardo de Azevedo Silva Rothe {BIO 18059993 <GO>}

Thank you, Jason. Well, we have several things that impact the first quarter that will not repeat; the same thing that we discussed one year ago when we also had in the first quarter of last year, lower number of current days and so on and so forth. So we have that again, not going to repeat throughout the year. So that adds to the net interest income.

We have -- the comparison is going to be better throughout the year. So we tend to move through the guidance for that as well. We've been disbursing more and the cleanup in our portfolio is almost done in some lines of credits. So for example, we are expecting the working capital for very small and small companies to increase, in fact, it has increased in April. So we expect the quarter to show a growth in working capital for very small and small companies that carries a very good spread.

We keep disbursing in several different lines of credit in the individuals and so on, so that's helpful. And throughout the year, we should move to the guidance. Of course, when we release the second quarter, we are going to carry the first quarter difference, right. So it's going to improve, but it's going to be below the guidance in the second quarter, but we are going to move gradually throughout the year until we reach the guidance at the end of the year.

Q - Jason Mollin {BIO 1888181 <GO>}

That's helpful. My second question is a follow-up on what you define as one-off items on a quarterly basis; and you're providing the data on slide 28, where you show the one-off that you described for economic plan. I mean, I understand of adjusting for this, because we've talked about this over the past, because it can be volatile. And I just wanted to understand the BRL539 million this quarter. I mean, are we getting close to an end here or should we continue -- I mean, it was about 290 million in the fourth quarter and 227 million in the first. So I understand looking at earnings without this effect, but I also think obviously it impacts your book value.

A - Daniel Alves Maria {BIO 17030121 <GO>}

Okay, Jason. Daniel speaking. Thank you for the question. Just the first quarter '18 wasn't abnormal, and there is an effect that we can explain. This was -- we had the room for these long-time discussed economic plans. And we had some anticipation of the executions before that -- these impacted in more payments in our side. Then, there is one effect that there is a delay between the payments and when we release provisions, because we -- there is a process that usually you follow-up in courts to do it. And this is one part that explains that.

The definition for the current plan, I think, our view that is very good for the system, yeah, and for the favors as well. And now there is the process of entering in the agreement. Then we are going to see the normalization of these lines in the next years, yeah, as we have the agreements (inaudible) the agreement to normalize [ph] it, yeah. Then, I would say that we believe that this turns to a normal number, yeah, that we are going to see in the upcoming months.

Q - Jason Mollin {BIO 1888181 <GO>}

And is that going to be more in line with what we saw in the fourth quarter and first quarter or even lower than that?

A - Daniel Alves Maria {BIO 17030121 <GO>}

Jason, it's hard to say at this time, because there is time for those agreements, then we need to observe a little bit more, we need to create more series to say something, yeah, but certainly there is a trend to go to normal numbers.

Q - Jason Mollin {BIO 1888181 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Ms. Natalia Corfield from J.P. Morgan.

Q - Natalia Corfield {BIO 6421991 <GO>}

Hi. Good morning, everybody. Thank you for the question. It's a follow-up on the rationale on the capitalization and the payout ratio. I think the rationale for the increase in the payout ratio at this point in time is clear. However, Banco do Brasil still has one of the lowest core equity ratios, I think, in Latin America. I understand that you want to grow this to 11% by 2022. But in -- just to understand, given the balance of dividends that you want to pay in the level of your core equity, what would be the core equity ratio that Banco do Brasil would be comfortable with; would that be the 11% or is it another number? Thank you.

A - Bernardo de Azevedo Silva Rothe {BIO 18059993 <GO>}

Okay. Natalia, thank you for your question. Well, 11% over time is the minimum, right. So we don't want to stay at a minimum. We always work with some level of additional buffer over our own minimum, right. Just to remind you, before our Basel III and so on, we had the minimum of 12% and we were operating at 14% for the total ratio, right. That was before the Basel III will start to -- I mean, deployed and the collective one was not so important at that time we follow pretty much more the total capital ratio and that's when we build our capitals, total capital base on Tier 1s and Tier 2s as well that are more efficient for investors.

Right now, we have a very high total ratio of over 18%, right, after the total deduction. So we have a lot of room to manage the capital base and we have a clear growth of 11% as a minimum. We should be working -- operating close to 12% over time, right. And that's what we should -- to have room, to take opportunity in the market, there are opportunities to be taken, right. So we can take the opportunity and still be over our own minimum of 11%. So 12% is something that we look at where we should be close to over time and our projection is that we are going to reach our minimum target before as we reached the 9.5 way before one year in advance, we should reach the 11% also in advance of 2022. And we should be, in the long run, running close to 12% with another 1% over our own minimum.

Q - Natalia Corfield {BIO 6421991 <GO>}

Okay. So overall you think that you can run at the 12% and you can still increase your payout ratio? And even it's a higher payout ratio, you will still be able to deliver a core equity around 12%?

A - Bernardo de Azevedo Silva Rothe {BIO 18059993 <GO>}

Exactly.

Q - Natalia Corfield {BIO 6421991 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Mr. Alex Christopher from UBS. Mr. Alex Christopher, you may proceed. This concludes today's question-and-answer session. I would like to invite Mr. Daniel Maria to proceed with his closing statements. Please go ahead, sir.

A - Daniel Alves Maria {BIO 17030121 <GO>}

We thank you all for attending our conference call. And is there any further question, we are available for that. Have a nice day and have a nice weekend. Bye.

Operator

That does conclude Banco do Brasil conference call for today. As a reminder, the material used in this conference call is available in Banco do Brasil Investor Relations website. Thank you very much for your participation and have a nice day. You may now disconnect.