Conference Call Transcript
Banrisul (BRSR6 BZ)
1Q15 Results
May 14th, 2015

Operator:

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to Banrisul's 1Q15 Results Conference Call. Today with us we have Ricardo Richiniti Hingel, CFO and IRO; Werner Kohler, Head of Accounting and Andre Pedro Ponzi, Head of Investor Relations. We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the company's presentation. After Banrisul's remarks are completed, there will be a question-and-answer section. At that time, further instructions will be given. Should any participant need assistance during this call, please press *0 to reach the operator.

The audio and slide show of this presentation are available through a live webcast at www.banrisul.com.br/ir. The slide show can also be downloaded from the webcast platform in the Investor Relations section of this website. There will be a replay facility for this call for one week.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Banrisul'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 Banrisul and could cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Mr. Ponzi, Head of Investor Relations, who will start the presentation. Mr. Ponzi, you may begin the conference.

Alexandre Pedro Ponzi:

OK. It is a pleasure for receiving you at our 1Q15 conference call with the results. And I'd like to go straight ahead to slide number three with the income accounts presentation of our NII and NIM. We have seen a huge strong growth both quarter-on-quarter and year-on-year of NII and NIM altogether. NII increased 21% year-on-year and 5.4% quarter-on-quarter, reaching R$1.05 billion at the end of March this year, which represents a NIM of 7.8%, the highest of the last five quarters in a row.

Next slide, provision expenses. This is the one-off point of our quarter numbers. We assume that this is not representative of the whole year of 2015, in which there was an increase that helped provision expenses reached R$404 million again increasing 106% year-on-year and more than 70% quarter on quarter. This increase is related to the rolling over of our portfolio credit, also the NPL that we have seen spiking a little bit over the last quarter.

And more importantly, of the events from Chapter 11, judicial recovery from very few companies that are related to the corporate segment of customers that have sought this very specific instrument and therefore they have increased our provision expenses in a way that was not representative of whatever expectations Banrisul may have for the remainder of the year. Again, we would like to reinforce that we're not expecting to get to the level of R$400 million in provision expenses occurring in the coming quarters.

With the growth of provision expenses faster than the growth of our margins, the net profit of financial income is a reduction of 3.7% year on year. Our funding has remained at a very low cost in relation to our peers about 85% of the SELIC rate. Our loans to deposit ratio has remained stable at less than 90% in relation to deposits alone. And if we include our total funding subordinate debt and also the issuance of financial bonds or *letras financeiras*, it would be less than 80%, 77.6%.

In relation to our funding base time deposit has been always the key driver for growth and the key financial instrument that Banrisul offers to its customers in order to obtain cheap cost of funds with the balance of R$23.4 billion, it represents about 66% of our total fund.

Services fees, a very strong quarter – a very strong year-on-year performance more than 21% of growth in relation to what we had accrued at the end of the first quarter 2014. In relation to December's number, there is a slight reduction 2.5%, on account of seasonal factors given the strong performance of the value months of each and every year. And again, a very robust growth that has been driven by mostly four drivers.

One is the collection of fees from customers, which increased from R$93 million from R$86 million last year, 8.5% growth; credit card increased to R$57.5 million in terms of fees from R$42.5 million at the end of March last year, 36% growth; but more importantly from two very specific drivers, which is the card business, the acquiring business and the issuance of voucher cards, which has grown to R$103 million in terms of fees from the R$73 million that we produced in March, 41.2% of growth. And insurance and pension plan and bonds that have contributed to R$38 million of the fee that we produced in the first quarter this year in relation to the R$28 million 1Q14, 36% growth.

Representative of the largest portion of the growth indices in this quarter is the fees, the fees that are produced from the acquiring network, the Vero acquiring network. The number of affiliated merchant stores has increased 17% year on year, 3.3% quarter-on-quarter and it's totaling now more than 166,000 merchants connected through our proprietary acquiring network. This acquiring network has produced transactions in the amount of R$54 million last quarter, a slight reduction from 4Q14, seasonal factors again, but a strong growth of 34% over 1Q last year. And it's represented by about 60% of debit card transactions vis-a-vis the 40% that is coming from transactions made with the use of credit card.

More importantly than the number of transactions themselves, transactions again, there'll be a connection with expenses that we have produced over the year is the financial turnover that we have seen produced by this acquiring network increasing 44%, vis-a-vis December last year there is the seasonal factors helping reduce by 7% the financial turnover. But if we compare, there is a balanced distribution between credit and debit card transactions.

Our recurring administrative expenses increased overall in personnel plus other admin 14% year-on-year and reduced by 4% quarter on quarter. Personnel expenses, they increased a little less than 13% year-on-year and they reduced 3% over December. And this has happened in a period in which our payroll or the headcount reduced in 379 employees, about 3% of the headcount we had in March, the personnel expenses were impacted by the collective bargaining agreement that was negotiated in September last year, meaning that we have had two quarters in a row of higher personnel expenses and also, and more importantly, by the increase in terms of the contribution that Banrisul paid to Fundação Banrisul to employees, especially those who have switched from the defined benefit plan to the variable contribution one, in which the level of contribution – payments that Banrisul places, Fundação Banrisul is now balanced 50%/50% vis-a-vis the 38% that Banrisul was contributing over until 2014.

This increase in contribution, the payment of contributions to the pension plan, which increased recurring expenses is more than beneficial for Banrisul because it has reduced hugely any impact that may come and that may arise from further deficit that the defined benefit plan present in the coming years.

And other administrative expenses, which increased 15% year-on-year, but with a very strong reduction of a less than -- a little less than 5% over December's number. They have to take into consideration what we are and have been addressing the market. Variable expenses that are related to the card acquiring business and with the origination of payroll loans outside our branch network or with the use of the banking correspondents.

If we do exclude these two items, we would have seen that our other fixed costs would had grown 0% quarter-on-quarter and only a little less than 6.5% year-on-year, which is in line to whatever inflation indexes that you may have seen in Brazil. But the two main drivers for the increase of variable costs are related as you can see on slide 11.

With the card business, in which expenses have increased from R$38.5 million to R$62.3 million, an increase of 62% vis-a-vis an increase of the gross income that we have produced from R$115 million to R$160 million. We have maintained a multiple of more than R$2 – a little less than R$3 for each and every BR$1 that Banrisul has invested in the card acquiring problems.

The other main drivers for the increase of expenses is related to the payment of commissions and to support the banking correspondent by the reduction of payroll loans off branch network in which we've seen expenses increased from R$40 million to a little less than R$62 million, a growth of 53%.

On the other hand, the gross income that we have produced from the payrolls that we originate off branches, they have increased 50% in the same period from R$98 million to R$145 million this year. Again for every real that Banrisul has spent in terms of investments in these products, we have produced R$2.5 in terms of revenues. And this is related to the balance of credit that we have produced with the use of our banking correspondent that reached R$2.7 billion from the R$2.1 billion that we have at the end of March last year.

Other operating income and expenses, they have been impacted by the FX variation that we have seen affecting the equity of our branches abroad, which in line have coped with a slightly increase in labor provisions that we saw over the last quarter. All said, net income has reached BRL147 million growing a little less than 7% over 1Q, 2014 and reducing by 17% over December last year, all recurring and adjusted net income.

Total assets reached R$61.4 billion, increasing a little less than 7% year-on-year and 3% quarter on quarter. Our liquidity has increased by 16% year-on-year and this is related to Interbank deposit deducted of repurchase obligations. Loan portfolio R$31 billion almost 14% growth year-on-year, a little less than 2% quarter-on-quarter is related to the growth of direct lending 19% year-on-year, 2.3% quarter-on-quarter, which represents a little over 30% of our total loan book, and non-earmarked credit portfolio R$21.5 billion, 11.6% increase from March 2014 to March 2015, 1.5% from December 2014 to March this year.

Provision expenses impacted by the flow of expenses in this quarter that we would like to reinforce that is not likely to be occurring in the coming quarters reached R$1.8 billion, which represents 6% of our total loan book, almost the same level of the same percentage that we had last year, 5.9%.

The breakdown of our credit portfolio, we can see that non-earmarked credit represented by individuals with 38% and corporate credit and to corporations 31%, total about 70% of our total loan book. The other direct lending the most representative ones are real estate about 11% of our loan book; agricultural lending 8.5%; and credit for development long-term 8%.

Credit for corporations is mostly driven by working capital that represents 72% of this very specific portfolio and from this specific portfolio is where NPLs and provision expenses are coming from. In terms of the loans to individuals, 76% is represented by payroll loans, which are mostly 99% comprised by civil servants both from state local municipality and federal ones and also including recurring from INSS. And it's broken down into portfolios of own origination, meaning with the help of our branch network, 40% of this specific portfolio; the banking correspondent or BEM 26%; and the acquisition of portfolio from other banks 9.6%.

The breaking down of our funding and assets under management, R$49 billion, 14% increase year-on-year mostly represented by deposits R$34.7 billion. Our foreign bonds R$2.7 billion. Local funding, which is the local financial notes that we have, the *letras financeiras,* R$2.8 billion and assets under management, R$9 billion. Equity impacted by the incorporation of the results, net of the dividends that we paid, R$5.7 billion, increasing 11.3% year on year and 1.2% quarter-on-quarter.

Next slide, our main structural and financial indicators. Coverage ratio for 90 days 169% and for 60 days 141% return on that, which is similar to the levels of last -- first quarter last year a little less than 11%, we are not comfortable with this level since the only point of our guidance that has been off of the range that we have announced when we released 2014 numbers. NPLs for 60 days increasing from 3.8% to 4.3%, 90 days increasing from 3.4% to 3.55%. Return on assets with the same trend of the return on equity 1% similar numbers of March last year.

We have increased efficiency slightly from last year to this one from 55% to 54%, taking in accounts that fees are now covering a higher portion of our personnel expenses vis-a-vis what they covered in March. We are now being able to support almost 85% of our personnel expenses, which increased almost 13% with fees on account of the huge and still ongoing momentum of the performance of fees.

Basel ratio at a very comfortable level, a Tier 1 plus Tier 2 capital, 17%. Number of headcounts being reduced by 3%, 379 employees left the bank in one year, totaling now 11,588 employees. The branch network broken down into branches themselves and service stations. We get each in our eight new points in total to do so, but more important is the transformation of the mix in which service stations are being transformed into full branches in order to support the offering of products regardless of financial or more importantly services year-on-year.

The next slide of our presentation is the guidance, in which before releasing to the market we have a thorough discussion and given that apart return on equity none of the other items of the guidance have been off range. We have decided to maintain and considering that the provision expenses flow is not likely to be reproduced over the coming quarters. We have decided to maintain and to preserve the guidance as it is. We assume that the range may change. We were expecting that some would go closer to the bottom range of the guidance. They could be now moving towards the high end of the guidance itself, but still in line to the numbers that we have produced.

Having said that, I conclude the presentation itself and I'll now pass the floor onto Mr. Hingel for some considerations before opening to the analysts to Q&A session. Thank you.

Ricardo Richiniti Hingel:

Good morning for all. And before I answer the questions, I will do a small overview about the situation and especially about the environment that we are living. So it's very important to understand the best performance of the Brazilian economy last year and of course it didn't change in the current year and we will remain at negative view for 2015 and 2016 and this is the one, where the market we are living today.

So, it is very important to highlight what the governors are doing today trying to recuperate the creditability of the Brazilian economy especially in the negotiations of the fiscal adjustments. I believe they will have success and the market is just understanding this. Not, maybe, not the perfect success, but there are available success.

And what we hear, the problems are in the 1Q of the current year is basically the best level of the expectation about the Brazilian economy and we can summarize this in the perspectives of the inflation. Inflation in Brazil grows to 8% by year is very expense and very high, and that made the Central Bank introduce a very high monetary policy, increase in the SELIC rate and keeping a very high level of demand deposits. The liquidity of the economy has reduced by monetary policy from the Central Bank.

And that impacted the performance of the whole economy during the 1Q and that explains part of the performance of the Bank especially when we look at delinquency and then level of provisions that we need to do. The level of provisions that we did represent the general problem of the economy, and we have to add, to understand this, if some special operations that we did to our account and that impacted negatively in the level of provision.

We do not understand that it is a trend today; we understand, especially analyzing the behavior of the correct portfolio to-date, in April it was just different and we don't believe the level of provisions that we look it during the 1Q will continue. We're always saying you don't have to multiply by four the level that we got in the 1Q.

And the other points that we have some points that we need to highlight that is very positive for the bank. The first is, I'll highlight is the margin, the financial margin of the bank. The financial margin of the bank has impacted by the monetary policy from Central Bank that makes the banks re-establish the price of the interest rate. We just -- the bank have the whole market in Brazil increase the cost of credit in Brazilian debt that explains the big part of the increase of the financial margins that we got in that first quarter. And that trend I believe will continue during the current year.

That it is important to highlight we just – especially today for example, we reprice it – we reprice it the whole credit of the bank. The interest rate of the whole credit lines of the bank has established with a new price or extensive price to-date. And during the year, we will collect the benefits in terms of results of the new prices of the credit portfolio. We believe the risk of delinquency can continue during the year, but this is the environment, the economic environment of the banks or the banks in Brazil representative of one of the low performance of the economy.

The Brazil had a stagnation performance in 2014. And we understand the growth of the economy in Brazil in 2015 will be negative between 1% and 1.5% will be the performance of the Brazilian economy that is the worry that we have to run the business of the bank. We are managing, especially and the way we are managing, especially after the win and we changed the management of the bank one month ago and we are communicating for the whole people of the bank, the whole employees of the bank that the policy – the current policy – the current policy care a lot of the portfolio of credit of the bank. And we knew, we understand delinquency essential, also of the management that we used to treat that portfolio.

With the targets of the decision of the bank that we are charging so from our branches and our employees is care, a big care of the delinquencies with this negotiate or and to try to reduce the current level. It is important again, the performance of –we are very satisfied with the performance of the credit, the card business of the bank and even they should going -- the revenues from insurance that we are collecting will be, will represent our growth participation in the revenues and the results of the bank.

We are working a lot in this business part of the policy, the strategic policy of the bank. And we believe during that year, we will grow and we will occupy the big part of the potential yet we have to grow in that two new businesses. It's important we are trying to show to the market that the insurance, the revenues from insurance and from credit card is now the core business of the bank. The market analyzed the bank and the standard bank, they are basically a credit bank. Now, the challenges that we have is make that two new business quite last the core business event together with the credits.

And this is only the first overview and the first marketing average, whereby I'd like to present for you. And now we are ready to answer the questions that you'd like to do. Thanks.

Saul Martinez, JP Morgan:

Hi, guys. I get what you're saying about the provisions probably moving down in the coming quarters off of a very high first quarter base, but your cost of risk was 5.3% in the first quarter. By my rough calculations to be at the high end of the range, you have to have like R$225 million on average of provisions that's a little more than half of what you did in the first quarter.

Given everything we're seeing in not only the country, but Rio Grande do Sul where the NPL evolution for corporate has deteriorated substantially, you have a government with fiscal issues. I don't understand, can you walk me through some of the numbers as to why you feel the provisioning levels can come down so substantially off of the first quarter base, do you have, how much did you make for some specific corporates, do these go away, just give me some color because it's very hard to understand the numbers given what you saw in the 1Q? Hello?

Alexandre Pedro Ponzi:

Yes. We did experience some trouble with the communication, it was hard to hear from you the last part of your sentence. But first of all, what has happened? From the corporate segment, we have seen the companies that have been affecting NPLs over the last quarters. They enter this Chapter 11 of judiciary recover, and therefore they stopped making any payments.

And not only did they stop, but it has become harder for us to do whatever negotiation, whatever effort that we can in order to try and solve this problem because this is in negotiation from the moment that they file for this judicial process altogether.

So, we do have a good number, about a R$300 million – R$360 million of outstanding balance that is coming from this corporate segment mostly, not one single industry sector alone, but the most representative is the metal-mechanic one, that is impacted. And therefore this has increased the amount of provision expenses, some many of those companies they have been upgraded from the breaking levels that they have at the end of last year through the levels and therefore they are fully provisioned for, not impacting the slow of provision expenses in the coming quarters.

Now, considering that we have been selective in terms of the vintage of credit that we have originated, we assume that just the rolling over of the outstanding credit balance, putting aside these sectors that we do not control, institutions on Chapter 11 problems, we assume that the numbers that we have seen, the preliminary data from April, not a full data yet, but a preliminary one, and that we have sort of returned to the levels of the previous quarter, which were not lower ones. Last quarter we produced, in March, December, R$240 million, if I'm not mistaken, in terms of provision. So but it's certainly reducing the impact of these one-off events that we do not expect that they will happen at least not at the very same pace in the coming quarters this year.

It's hard to say the whole 2Q we'll see the full benefit of these expectations that we have, but we assume that for the remainder of the year, it is likely to reduce the provisions for to a two-one mark level in relation to what we saw in the 1Q.

Saul Martinez:

You mentioned R$316 million from, is that from companies who have entered into judicial processes?

Ricardo Richiniti Hingel:

It would be closer to R$350 million.

Saul Martinez:

R$350 million, sorry, OK. Then how much of that have you reserved for?

Ricardo Richiniti Hingel:

We may have provisions for a good portion of those companies that have reached below 18th. If you want components then we need to remember the rule that the Central Bank has over this portfolio that is outperformed. In the end of the last year, these companies were in the C, D or at each level that the Central Bank requires 3%, 10% of the loss over this portfolio.

And these companies entered into Chapter 11, they stopped all the way to get to the right level and the right track of this portfolio. Then we need to account as a provision for this portfolio around 7% of all the debt these companies have with the bank. Then that's why in this quarter, we needed to account so high level of expenses with these companies and provisions. And that is why we think that in the next quarters, this will be in the right level again.

Saul Martinez:

Of this R$350 million, two further questions and then I'll go, this R$350 million of exposure, do you see further downgrades to higher segments, one. And two, why do you worry that there will be more companies entering into Chapter 11 given the economic backdrop?

Ricardo Richiniti Hingel:

Well, we have and this portfolio that Alexandre has said, the amount is R$350 million, we have some of these companies that is not in the Chapter 11, then we have room to put this portfolio in the right track again. And the most important part of this is in the each level, then the most important part is a 100% accounted as allowance.

Saul Martinez:

OK, thank you.

Operator:

Having no further questions, this concludes our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

Ricardo Richiniti Hingel:

Thanks for all. We are available for next questions, please ask for us and the conference call to show more details about it. But just to finish I'd like to highlight, the policy of the bank is to continue carry quality of the portfolio. And we believe, we are very likely to manage this. We know and we realize, and recognize that we're living in a very complicated economic scenario.

But the total efforts of the current strategy of the new management of the bank is continue increasing the revenues from other business as I said before especially revenues from services like credit card, that we are very competitive growing in the transactions in that segment and even in insurance.

I'd like to highlight that we forecast growth between 40% and 50% in one year. The revenues from those two segments, we are very optimistic and very confident that we will reach that segment to compensate the performance that we are hoping from the quarter. That is the message that we'd like to present now. And thank you very much for everybody and for attending our conference.

Operator:

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.