International Conference Call
B3
First Quarter 2017 Earnings Results
May 11th, 2018

Operator: Good morning ladies and gentlemen, and welcome to the audio conference call about the earnings results of B3 for the First Quarter of 2018.

At this time, all participants are in a listen-only mode. Later we will conduct a question and answer session and instructions to participate will be given at that time. If you should require assistance during the call, please press the star key followed by zero (*0).

As a reminder, this conference is being recorded and broadcasted live via webcast. The replay will be available after the event is concluded.

I would now like to turn the conference over to Mr. Daniel Sonder, Chief Financial Officer of B3.

Mr. Daniel Sonder: Good morning. I'd like to welcome you all to B3's first quarter 2018 earnings conference call. I'm here with Rogério Santana, Head of the Investor Relation team, as well as the Finance and Investor Relations teams, and I would like to start by thanking them for preparing the documents you have in front of you.

And additionally, on behalf of the entire executive team of B3 I would like to thank all of you for your continued trust and support.

Let me take a moment to highlight that, in order to preserve comparability, the year-over-year analysis is based on a non-audited combined income statement for first quarter 2017, which includes BM&FBovespa and Cetip's figures for that quarter.

I'll start the presentation on slide 3, where we show the operational and financial highlights for the quarter. As we will dive into further details throughout the presentation, we had a very strong performance this quarter with 4 out of 5 of our major revenue groups growing at a double-digit pace.

Average volumes grew around 40% in both BMF and Bovespa segments and reached all-time highs while the numbers of vehicles financed increased in the high single digit, positively impacting our liens and loans segment.

Our systems were fully prepared to deal with these unprecedented volumes witnessed in some of our markets. This was only possible because over the past years we have made significant investments in our IT infrastructure, raising the bars in terms of performance, risk management and systems availability.

On the right side of the slide, we see that our revenues grew by 18% year-over-year reflecting the very strong operating performance in the first quarter of 18. It is important to mention that first quarter 18 had 2 working days less than in the previous year, which offsets part of the volumes growth previously mentioned.

Adjusted expenses reached 225 million, 2.9% lower than in the first quarter of 17 since the positive impact from synergy gains more than offset inflationary adjustments that apply on wages and contracts, which represent a significant portion of our expenses.

Ebitda adjusted for nonrecurring items was 760 million, more than 18% increase versus the previous year. Despite such increase, Ebitda margins were stable, around 68% since they were impacted by the increase in provisions for legal disputes, in which part of the amount under discussion is updated according to the market prices of our shares B3SA3.

Additionally, the increase in revenue-linked expenses also led to stability of Ebitda margin, and we will go into more details about that later on. Recurring net income reached R$448 million, a 15% decrease mainly explained by a lower financial result as we currently hold a smaller cash balance versus last year first quarter as a result of the transaction with Cetip, which was paid for at the end of the quarter in 2017.

Now, Rogério will give more details about our operational performance.

Mr. Rogério Santana: Thank you Daniel. Good morning everyone. I would like to ask you to move forward to slide 4, where you will see the revenue performance and breakdown for the first quarter of 2018.

In the bar chart on the left side, we see that revenues from all 5 segments grew year-over-year, leading to 18% growth in total revenues. The highlights were: The BM&FBovespa segment as well the Cetip's liens and loans segment. This last one was impacted by changes in the business model of some services, and we will go into more details in the coming slide.

In the pie chart on the right side, we see the breakdown of revenues for the quarter, which shows, once again, how highly diversified and well-balanced our business is.

Moving to slide 5, you will find details of the financial and commodity derivatives market performance, where we had a 24% revenue increase year-over-year. As you can see, we experienced significant volume growth in all groups of contracts. The 2 most significant groups of contracts (the interest rates in BRL and FX rate contracts) grew around 30% year-over-year, while stock index contracts more than doubled in the period.

On the other hand, the average RPC fell 4.7%, reflecting higher share of day traders and high-frequency traders that are illegible to discounts. These 2 groups of investors are becoming more relevant in the mini FX contracts and mini stock index contracts and putting more pressure on the average RPC of those 2 groups, as you can see in the table on the bottom right of the slide.

In the slide 6 we have the performance of the equities market in the Bovespa segment, where we also saw revenue growing more than 30% year-over-year driven by a 40% increase in the ADTV, which went from R$80 billion in the first quarter of 2017 to R$11.3 billion in the first quarter of 2018, all-time high for these segments.

This performance reflects the continued recovery of the Brazilian equities market, which is advanced by the 29.4% increase in the market capitalization of Brazilian-listed companies. Turnover velocity also showed solid growth from 71.1% in the first quarter 17 to 77.7% in the first quarter 18. Both performances are shown in the bottom right chart.

Trade and post-trading margins fell 3.6% year-over-year due to lower participation of equity derivatives and the discount triggered by higher volumes traded. In the first quarter 18, the ADTV was about R$9 billion in every month of the quarter, and as you know, this is the first threshold that triggers volume discounts to the market.

Next, in the slide 7 we present the performance of the Cetip securities segment. The value registered of fixed income instruments was up 12% driven mainly by increase in issuance of bank deposit certificates (or CDBs), this increase in turn propelled the outstanding value of fixed income securities, on which maintenance fees apply, which reached R$4.5 trillion in the first quarter of 2018 and raised 13% year-over-year.

Revenues generated by monthly utilization fees paid by our clients grew more than 20%, mainly reflects the new pricing policy implemented in January 2018.

Finally, it's worth noting that the first quarter 2018 revenue in this segment reflects the full impact of the sharing of expenses synergies that arouse from the business combination with Cetip, which was translated in price discounts amounting R$7.8 million and applied on different revenues in these segments.

In the slide 8 we show revenue for the Cetip liens and loans segment, which grew 16.1% over the first quarter of 2017 propelled by an 8.5% growth in the number of vehicles financed in the period.

The company's market share in the contract system contracted to 66.7% in the first quarter of 2018 versus 74.4% in the previous year first quarter. This reduction is explained by the fact that B3 has not offered the contract system service in the state of Minas Gerais since September 2017.

The most relevant issue in this segment has to do with the new business model for the contract the system adopted in the state of São Paulo, which positively impacted the revenue from this segment. I will go in more details on that in the next slide.

As you can see in the slide 9, the contract system service was impacted by the adoption of a new business model in the state of São Paulo, which introduced a new player in the chain used to register a loan in the local DMV of each state.

Under this new model, B3's transmits on behalf of its clients detailed information about loans to an accredited registering company, which in turn registers the contracts with the local DMV.

In the previous model, B3 transmitted this information directly to the local DMV, which executed the registration of the loan. Under this new model, we now bundle in the price charged by B3 from financial institutions both the fees related to our own services and the fees related to the services provided by the registering company.

This had a positive impact on the revenues reported under the contract system, as we discussed in the previous slide. On the other hand, the amounts related to the services rendered by the registering company is booked as an expense by B3 under the expense line 'third-party services' and thus, while revenues went up, so this expense.

B3 worked with its clients and other partners to adjust several aspects of the economics of this business, and yet, there was a negative impact for B3. In summary, under this new model, the total fee per contract transmitted will increase from R$55 per contract to R$90 per contract, while revenue-linked expenses will increase from R$14.9 per contract to R$57.6 or contract, growing proportionally more than revenues.

These explains why the earn from each contract transmitted will decrease to R$26.34 per loan transmitted after paying the costs of the services provided by the registering company, the sharing of revenues with other partners and the taxes on revenues. It means a 30% reduction in our gain. In the previous model B3 used to earn R$37.5 per contract.

These changes are fully reflected in the first quarter of 2018 results. Additionally, B3 has worked on an initiative to offset most of the negative impact from this new business model, and the rollout of those initiatives is expected for the coming quarters.

Finally, if other states migrate to the same model adopted in São Paulo over the next quarters, B3 revenues and expenses will be impacted again.

Now, I will hand over the presentation back to Daniel, who will detail our expenses and other financial highlights.

Mr. Sonder: Thank you Rogério. On slide 10 we have updated information on expense guidance for 2018 and the actual expenses for the first quarter of 18.

B3 reviewed its guidance for 2018 full year adjusted expenses and started to disclose also the range for revenue-linked expenses. We believe that given the changes in the contract system described previously by Rogério and the relevance of such expenses in the total expense of the company, it would be helpful for investors to have an additional breakdown of our expense guidelines.

This would allow investors to track the adjusted expenses of B3 over time making a system comparison of those expenses which are not linked to revenues while also having visibility of the expenses and [0:13:53 unintelligible] type of the performance of our revenues particularly of the contract system.

The 2018 guidance for depreciation and amortization and expenses related to the business combination with Cetip are reaffirmed and have not changed. I will skip the explanation on adjusted expenses because I will cover this in the next slide.

So, starting at the depreciation and amortization line, the main highlight is the fact that in the first quarter of 18 the numbers include 187 million in amortization of intangibles recognized in the context of the combination with Cetip, the amortizations of these assets started in April 2017, so were not there in the 1Q 17.

In the case of the expenses related to the combination with Cetip, we see a significant drop in that line, reflecting the fact that we have moved forward in the integration process.

When we look at revenue-linked expenses, as Rogério explained a minute ago, we note that this group of expenses was impacted by the new business model adopted in the state of São Paulo for the contract system. From now on, these expenses will be more exposed to the market activity in the Cetip liens and loans segment. Also, if other states adopt the same business model, the guidance of 200 to 220 is likely to be revised, as will be the case if the performance of the segment differs significantly from our forecast.

The only 2 groups of expenses for which there is no guidance provided are stock grant expenses and provisions. In both cases, a significant portion of these expenses is directly linked to changes in the market price of our share B3SA3.

This significant year year-over-year reduction in these 2 groups of expenses is mainly explained by nonrecurring provisions booked in first quarter 17 and the concepts of the combination with Cetip.

In slide 11, the next one, we show the behavior of the company's adjusted expenses. Adjusted expenses reached 225 million, a 2.9% decrease year-over-year. Personnel expenses were close to flat despite the 3% annual salary adjustment and lower amount of personnel expenses capitalized in project. The synergy gains from the combination with Cetip is offsetting this growth pressure.

As we disclosed in December 17, all the decisions and measures that were necessary to entirely capture the expense synergies of the merger were made and executed by the end of 18. As a consequence, the first quarter of this year is the first quarter when we see the full impact of the synergy gains from the combination with Cetip

Between the years 2018 in 2020, the expense synergies will amount to R$100 million per year. In 2021, after the conclusion of the data center integration process, total synergies will increase to R$110 million yearly.

Moving to slide 12, we show our financial robustness with a solid cash position, which is an important part of the business of being a credible counterparty in the financial market. Our total cash amounted to R$7.5 billion at the end of the last quarter, composed by B3's own cash and third-party cash, mainly related to collateral pledged in cash by our clients.

In the light blue bars you will find B3's own cash composed of restricted and unrestricted cash, amounting to 5 billion in first quarter 18. B3's own cash includes the necessary cash to run the day-to-day activities of the company, that totals between 2.5 and 3 billion. This amount includes approximately 1.1 billion in clearing houses required safeguards. The remaining adds to the liquidity that supports our activity as a central counterparty and general corporate needs.

The cash balance at the end of the first quarter of 2018 includes R$200 million in interest on capital that were already paid in early May 2018. The bars on the left side of the chart show third-party cash, which amounted to 2.5 billion, mainly composed by market participants’ cash collateral of 2 billion.

It is important to highlight that the company earns interest income on most of this cash balance.

On slide 13 you see the company's debt profile and amortization schedule. Currently, our leverage is temporarily higher, with a gross debt to adjusted Ebitda ratio of 2 times in first quarter of 18. Our target is to reduce this ratio to one-time by the end of 2019 following the debt amortization schedule you see in the bar graph on the upper left side.

As you see in the chart, we have a 1.5 million debt amortization scheduled for December 2018. Considering the company’s cash position and the cash generation we forecast for the year, we believe we will be able to amortize this debt at the same time that we keep a payout ratio between 70 and 80% of the IFRS in income.

With that, I would like to conclude this part of the presentation and open up our question-and-answer session. Thank you.

Question-and-Answer Session

Operator: Ladies and gentlemen, we will now begin the question-and-answer session from investors and analysts. If you have a question, please press the star key followed by the one key on your touchtone phone now. If at any time you would like to remove yourself from the questioning queue, press star 2.

Our first question comes from Rubens Oliveira, Banco Plural.

Mr. Oliveira: Hi, good morning. I have 2 questions, they are related to the Cetip liens and loans segment. First, you mentioned that you were working on a series of initiatives which will be rolling out in the coming quarters. Could you give me a little bit more clarity on what exactly these initiatives are that you will be implementing and if there will be any new initiatives.

Also, my second question, I see on your slide here that have 2 states that are transitioning to the new business model and you are under negotiations with the other states that you currently operate. Do you have any probability that it will turn to this new business model, or not? Thank you very much.

Mr. Santana: Hi Rubens, thanks for the questions. Part of the answer for the first question has to do with your second question, because some of the initiatives that we are implementing is try to resuming our services or implementing or starting to offer our services in states where today they are not offering that.

So by doing that, using this new model we could increase our market share and partially offset the negative impact of this new model.

The other initiative has to do with the fact that we are revisiting some of the services, some of the discount schemes that we have, and so one and so forth. This is something that is under discussion currently with our clients and you expect that the in coming quarters we will be able to get more visibility on that and then have more clarity on what is going to be the final net impact for it.

Mr. Oliveira: Thank you.

Operator: Next question comes from Eduardo Nishio, Banco Plural.

Mr. Nishio: Hi, thank you for taking my question. Just a follow-up on that point. Is regulatory… I guess regulatory changes have been driving this new model, so would be that inevitable to see the new model rolling out to all estates going forward given this new regulatory frame? And if there is any kind of spillover effect from the GRAVAMES, the liens kind of business, as well as in the future given that this regulation has changed and probably DMVs are wanting to have a bit more share of the revenue pie?

And my second question relates to the dollar exposure. You know, we see in the second quarter the dollar appreciation. If you can remind us about your net exposure to the dollar and if everything is hedged or not, and if you can open that on the revenue and expense side as well. Thank you.

Mr. Santana: Hello Nishio, this is Rogério, thanks for the question. Regarding your first question, we expect that some other states will, in the coming quarters, migrate to this new model. But as you know, we do not control this process because it has to do with specific regulations released by the local track departments.

In our view or based on our expectations, probably we are doing to see more estates moving in this direction in the coming months.

Regarding the liens business that you mentioned, there is a new regulation that is the resolution 689 that is going to be implemented in September this year, this new regulation is currently under discussion with the national DMV, as well as with ourselves and the banks and other third parties, probably we are going to see some changes in the regulation, and specifically regarding what could be the impact for our business, we are optimistic that we are going to preserve maturely all the liens business that we have today.

Mr. Sonder: Thank you for the question. On the FX exposure, we have about 10 to 15% of our revenues exposed to FX, which have to do with the contracts in the futures division, in the BM&F division, that are basically the dollar-linked futures and that's about 10 to 15% of over revenue, as well as a little bit of market data and also dollar-denominated swaps in the OTC segment.

We do not have any longer any hedges for that in the revenue side, so we are fully exposed to the FX changes on the revenue side. On the expense side, we have about 3% of our total expenses are dollar-denominated, but we do hedge I would say probably 2/3 of that for the full year, early on every year, so for that to make our handling of our budget process and also the guidances more, let's say, robust. So we are fully hedged, not fully, but we are almost fully hedged on the expense side.

We also had some liabilities in US dollar, the 2020 bonds are fully hedged, both for principal and coupon payments, and we have a direct loan that is also, let's say, structurally hedged through the loan structure debt that we did through a foreign subsidiary. So on the liability side, we also have no exposure.

Mr. Nishio: Great, thank you so much.

Operator: The next question comes from Gabriel da Nóbrega, UBS.

Mr. Nóbrega: Hi everyone and thank you for the opportunity. I just wanted to have maybe an update of the competitive environment with some ATS. Do you think maybe ATS could be operating this year or maybe even in 2019, and how could that impact your own business? Thank you.

Mr. Sonder: Thank you for the question Gabriel. We are following that situation, as you know, we have done some preliminary tests with a potential new entrant, as was our commitment with our regulators and with the antitrust regulators, so we are following that, but we have no way to give you a precise timetable, I think that the timetable for their entering into operation will depend on their ability to obtain the approvals from the several regulators, as well as complete the tests with us.

There is, as you know, an ongoing arbitration discussion regarding one of the parts of our infrastructure, which might be required, which is the depository services for them to enter into operation, but I think that, again, the schedule will depend on them obtaining the approvals from the regulators, as well as dealing with certain legal and reputational issues, which you might have become familiar with through the news.

Mr. Nóbrega: All right, thank you. And if you allow me to make a second question, it's regarding your pricing committee. We have seen fees and your margins coming down this year. Could you maybe give us an update of how this committee is ongoing? So what points do you expect on prices to continue on compressing? Thank you.

Mr. Sonder: Yes, I wanted to be very emphatic and separating the fact that our fees have come down from many discussions in the pricing committee. The fact that our fees have come down has to do with our pricing structures, which have insisted for several years and which have not changed at all due to discussions in the pricing committee, and as Rogério went through, they have to do with volume discounts, special categories of investors, day traders, high-frequency, as well as sort of the mix between longer-term contracts and shorter-term contracts, or mini contracts versus full contracts. These are the drivers of changes in our average fees and this has been in our pricing structure for several years. Full stop.

Next point is the pricing, the discussions with the pricing committee have been very, very fruitful, I think that we have established good working dynamics with a very senior group of market participants, this I think I was the intention from the very outset of this forum was to be able to transparently discuss with them some potential adjustments in our fees that can go both ways.

You know, sometimes we can propose upwards adjustments when that's justified with respect to international benchmarks and so forth, sometimes we may propose reductions that could come from our very sensitivity to, you know, what times are telling us, where potential additional volumes could come from if we change prices.

So, as this takes place, we will incorporate them in our discussions with the market and with investors, but at this point I can say that we haven't felt any concern or pressure from market players, including those that are represented in the pricing committee for us to have any sort of deeper or across the board reduction or changes in our pricing structure.

Mr. Nóbrega: Right, that's very clear. Thank you.

Operator: The next question comes from Luis Fernando Azevedo, Banco Safra.

Mr. Azevedo: Hi, good morning. I have 2 questions in the liens and loans segment regarding the registering model. So the first is: Regarding the new guidance of revenues-linked expenses, I'm assuming that this model is implemented only in São Paulo, or it moves to what proportion of your base? That’s the first question.

And the second is: What prevents the client of this service to bypass B3 and contract directly your partner in this service? Is it a matter of credibility, compliance, or B3 is still offering any essential service in the process?

Mr. Santana: Hi Luis, this is Rogério, thanks for the questions. So the budget that we discussed yesterday regarding revenue-linked expenses considers a scenario where not only São Paulo, but also a second estate migrates to this new model. So as a consequence, if over the year other states decide to shift to this new business model, there is a chance that we will be obliged to revisit this guidance in the coming quarters.

Of course, we still have additional revenue-linked expenses, we will also have at the same time additional revenues that today are not considered in our forecasts. So this is going to be the dynamic here, this 2018 is a kind of transition year that we will need to track month by month how it is evolving, okay?

Regarding… can you repeat your second question?

Mr. Azevedo: The second question is regarding the risk of a client the hires B3 for this service of bypassing B3 and hiring directly the B3 partner to reduce fees.

Mr. Santana: Thanks Luis. To be very frank, it can happen. There is no restriction that prevents the banks or any other financial institutions to connect directly to the register, but why they have not done that? it's because we have a very strong relationship, not only with the banks, but also with the Banks Federation and other groups of players and we are sure that the value-added by our services is the main reason why the banks choose to keep using B3 as a hub that will concentrate all the information on the loans and that this hub managed by B3 will connect to registering companies in different states.

So making a long story short, why the banks will keep using B3? Certainly because of the value-added it provides.

Mr. Azevedo: And also credibility maybe right?

Mr. Santana: It has to do with our long-term relationship with the banks. Of course, when you have this kind of relationship you build the credibility with them, they trust our services and the quality of it, our excellence and someone so forth.

Mr. Azevedo: In a follow-up if I may, do you think that with this new model you could access back Minas Gerais state?

Mr. Santana: It is a possibility. It is a possibility for Minas Gerais, it is a possibility for other states that we have not offered our services in the past. In the slide 9 of the presentation you see these estates in the gray color.

Mr. Azevedo: Great, thank you.

Mr. Santana: You are welcome.

Operator: Our next question comes from Frederic de Mariz, UBS.

Mr. Mariz: Good morning everyone, Sonder, Rogério, thank you for the opportunity. Just a follow-up on the ATS question. Can you just give us a bit of color how is it working on the testing side, on the pure data side? Are you connecting the CST with ATS? How are the tests? How much in Opex or in spent time should we expect on your side?

And then on this topic as well, obviously you won't be able to comment on the arbitration on details, but is it correct to say that they have 6 months to get to a final decision and that the decision will be binding? In other words, does it take us to the third or fourth quarter? If you could just provide a bit of color on the timing. Thank you.

Mr. Sonder: So Frederic, thank you. On the testing side, we did some again preliminary tests earlier this year in the first quarter, they did not take a lot of our time and effort, but obviously operations teams were engaged in doing that, it was connectivity tests only, not fully operational tasks end to end, and we will continue to do so as we are asked to do, and we are keeping obviously our regulators aware of the fact that we are doing this and of the efforts that we are engaged.

But it's not something that we are doing every week for several hours, at least not at this point.

With regards to your second point on the arbitration, there is no specific, let's say, timetable that we can share with you. The timing let's say, to kickstart the arbitration was something that we were committed to, if we hadn't reached an agreement up a certain point, the arbitration procedures could have been started, and they have, there is no timetable for them to end necessarily, this will be up to the arbitration court to decide at what pace they want to move forward with that discussion.

And, yes, the results will be binding with respect to the price for the depository services, which is what is under discussion, and yet the regulators… sorry, the CVM will have to, let's say, firm that they are also comfortable with such prices, because the final word on this is always on the CVM side and they chose the arbitration procedure as, let's say, a way for the parties to try to come to an agreement, and then for them to give the final validation and sign off on whatever price comes out of the arbitration procedure.

Mr. Mariz: That's very clear, thank you.

Operator: Excuse me, we have a question of Pedro Gonzaga, with Pacífico Gestão de Recursos, through the webcast:

“Was there any retroactive payment related to the change of the contract system model in São Paulo?”

Mr. Santana: Thanks for the question. This new business model was fully implemented since the beginning of January, so it applies from January the second until the end of March. So this is the impact that we see for the entire quarter, there is no other retroactive payments or expenses related to that.

Operator: The next question comes from Rogério Morais, with Kiron Capital:

"Are the revenues-linked expenses 100% linked to the '*Sistema de Contratos'*? Or is there other revenue considered in the guidance?"

Mr. Santana: It is roughly 95% of the revenue-linked expenses related to the contract system, there are other very small expense lines that, putting all together, does not sum up 5%.

Operator: This concludes today's question-and-answer session. I would like to invite Mr. Daniel Sonder to proceed with his closing statements.

Mr. Sonder: I would like to thank everyone for participating, and once again, please feel free to reach out to our investor relations team to have additional questions that we may be helpful with, and thanks to all the team here next to me for putting all this together.

Have a good day.

Operator: That does conclude the B3 audio conference for today. Thank you very much for your participation. Have a good afternoon and thank you for using Chorus Call Brazil.