Banrisul's 2Q20 Results Presentation

Conference Call – August 12, 2020

Operator:

Good morning, and thank you for standing by. Welcome everyone to Banco do Estado do Rio Grande do Sul, Banrisul's audio conference call to discuss the results relative to the 2Q20. Here with us, we have the following executives: Claudio Coutinho, CEO; Irany Sant'Anna, VP and Risk Officer; Mr. Marcus Staffen, CFO and IRO; Osvaldo Lobo, Credit Director; Alexandre Ponzi, IR Superintendent; and Werner Kohler, Accounting Superintendent.

We would like to inform you that this event is being recorded and all participants will be connected in listen-only mode during the Company's remarks. After that, we will start the Q&A session for analysts and investors exclusively, and then further instructions will be provided. Should you need assistance during the conference call, please request the help of an operator by pressing *0.

A replay facility of this event will be available right after its closure for a period of seven days.

Before moving on, we would like to state that forward-looking statements made during this conference call concerning the Company's business perspectives, including financial and operating targets and projections, are based on beliefs and assumptions on the part of the Company's management, and also on information currently available. Forward-looking statements are no guarantee of performance. They involve risks, uncertainties, and assumptions as they refer to future events, and therefore depend on circumstances that may or may not materialize. Investors should have in mind that general economic conditions, industry conditions and other operating factors might affect the future performance of Banrisul, thus leading to results that will differ materially from those expressed in these forward-looking statements.

Now I would like to turn the conference over to Mr. Claudio Coutinho Mendes, Banco do Estado do Rio Grande do Sul's CEO, who will start the presentation. Please, Mr. Coutinho, you have the floor.

Cláudio Coutinho:

Thank you. Good morning, everyone. I would like to thank you all the analysts and investors here with us for our earnings call. And I would also like to thank my executive colleagues.

Before starting, I will make a brief overview of the initiatives we have implemented vis-à-vis the pandemic. On March 16, 2020, it was a date where we got together and started dealing with this as a pandemic and started taking measures and implementing contingencies around the situation.

We moved all risk group employees to home, working from home and then we established an alternation of employees so that we would be reducing the possibility of contagion and keeping those able to work in their posts.

From then on, from March 16 to today, we have had an operating performance with no flaw, no interruption. There was no system failure. We performed very seamlessly due to all the dedication and pre-work of all the IT teams and other resources from the Bank.

Also during this process, we hired the Moinhos de Vento hospital to provide us the correct health protocols and service to employees. We have been with them in this partnerships since then to date, and this was very important for us to be able to overcome this difficult moment.

And throughout the period, we also maintained our in-person service at the branches. We selected different schedules from 10 a.m. to 12 a.m. to service the elderly and retired people and from 12 noon till 4 p.m. service offered in-person to other clients, but always with caution and respecting the sanitary measures.

Especially in the regions where the pandemic was most widely spread, we have this flag protocol with different colors, and the colors dictate where we can provide full-service or not. Once again, always providing service to our clients. That has never stopped.

And as to minimize danger, we also publicized our virtual channels, our service channels, which were remotely, and that kind of service grew exponentially during the pandemic.

From the economic and financial side, we were quite in line with what other banks did in Brazil. We allowed people to reprogram or reschedule their payment dates. And we called those measure REPACs. In other words, offering other credit lines to individuals, also real estate credit, small business owners as well are also serviced by that product. The idea was enforced to carry on with previously agreed upon contracts.

And the terms that we offered were pretty much the same as the ones we had before. And depending on the case, we would extend terms. This was done on a case-by-case basis, and the idea was to migrate our clients to the digital app so that they could carry on with their normal operations.

As in the loan department, we offered this new credit line, the rebate, as we call it. We received support from the government in that respect. And we also had to offer that to civil workers also in an agreement with the authorities.

And then, depending on the case, we would try to reconfigure contracts for loans. As a standard, the following three installments were revisited and then the remaining of the loan contract was renegotiated moving forward. That reconfiguration, of course, was done on a case-by-case basis depending on individual demands.

As in also in the agricultural front, we had this drought period in the state, which made things even more difficult for some of our clients. And several companies saw a sharp drop in revenues. Some saw a drop to something close to zero. So we granted an exemption to those clients in terms of those who have bought agricultural machinery through us. And this will last as long as this revenue drop lasts.

We also were able to discuss different insurance contracts, and we also offer a possibility of hiring insurance remotely. And we renegotiated the payment of installments to those clients. All of that has been done throughout this quarter, specifically.

We also adhered to a federal government program to help fund our payroll clients. We also adhered to PRONAMPE another program. Then we are never sick of the R$39,000 and that reached 9,000 clients, R$250,000, 85% of it covered our portfolio.

Also, emerging from this new situation. As I said, we implemented several different digital clients, and we saw the level of this increase to 75% in the quarter. In other words, 75% of our transactions of clients with us were conducted through digital channels. We continue to invest in customer experience, I think this is the future, not only the present, and we continue to invest on that front intensely.

I will now turn the conference over to our IR Officer. Marcus Staffen.

Marcus Staffen:

Thank you, Coutinho, and good morning, everyone. Before moving over to Alexandre to start beginning with the presentation itself, I would like to make a few comments. Starting on the agricultural part, the Bank launched for the next crop year 2020 2021, launched a new objectives with a growth of around 28%, R$900 million.

As a highlight, for the current's crop year '19, '20, we reached 97% of what we have planned. And that is quite interesting, especially in a moment, where rural and agriculture seems to be less affected by the pandemic, and maintaining interest and margins.

About the result of the 2Q, R$119.8 million and R$377.3 million, half of the semester mainly affected by the growth in provisions. It would be interesting to address during the presentation, we will go into more detail about this, that both our coverage index at around 230 for 90 days, as our total provision on our credit portfolio at 8.3%, we believe is quite adequate to our credit profile. Our credit portfolio has grown slightly only, modestly through the last 12 months, 5.5.

In the quarter saw a slight drop 0.6%. And for loans, we see a growth factor. Payroll loans, a growth of R$1.4 billion and it is interesting to note is that even in April and in the first 2 weeks of May, given all the new social distancing protocols and everything, that portfolio behaved in a slightly lower rate.

But then, as early as June, we resumed a good growth rate, especially in our bank correspondents. So we imagine that this would be an interesting driver for the coming months.

And lastly, it is also important to mention our current level of capitalization and liquidity. Our capitalization at 15.2% and 16% of total Basel with an interesting growth, our funding portfolios, especially CDB and sales account, 4.5% in the quarter and 11% in the last 12 months. And that does not represent an increase in cost. Our total funding cost remained at around 90% of CDI and given all that, we have no doubt in a firm that as soon as market conditions or when market conditions become more interesting, if I may, we will have the necessary tools to grow our portfolio.

I think to start, that is what I had. I give the floor now to Alexandre to continue the presentation, and we will be back for the Q&A at the end.

Alexandre Ponzi:

Thank you, Marcus. Thank you, Coutinho. So after what we have heard from our colleagues, events that impacted our results, especially in this year, we will now go straight to slide number eight, we have a net income snapshot. It is a recurring net income in terms of results, but it is made up in a period where there is nothing recurring as it has been addressed.

And then it also translates into a drop in the accounting when we compare that to previous periods at 54%. When we go to the adjusted recurring, when you compare with previous periods, a drop of around 53%, 40% when we compare year-to-date, in the half of the year, with the first half of last year.

There are some elements to be addressed. The bank has been controlling tech main expenses because of the growth of our digital channel, and some benefits we have been received, but it has mainly been impacted by an environment where financial margins are relatively stable.

We saw a reduction because of the pandemic of service rendering revenues, as you will see later. But the main driver had to be, of course, the provision itself. It is an adequate provision. As I said, the Bank has a more conservative profile be it under the cost provision itself or when we talk about the relation with the portfolio when compared to other retail banks.

Today, it is a provision, which is quite predicted, given the unpredictability of what might happen. Coming from a credit portfolio, which is not growing in consolidated terms, but which offers some hedging elements, which I will discuss later.

On slide eight, we see a slight increase in margin in the quarter 3% between March and June. But when we analyze the margin for the period, year-to-date, 6 months and compared it with last year, we see a drop of 5%. That 5% drop is driven by the fact that rates were reduced, but because of the specificity of the Bank, of the surplus, as I said, we have this conservative profile in terms of treasury management, and then on the next slide, you can see that quite clearly, the size of the final result in net terms for the Bank, comparing the two main drivers: the credit portfolio, which accounts for R$1.3 billion that the Bank generated in terms of financial margin in the 2Q, corresponding to 97% coming from credit operations, and 3% only coming from treasury because, as I said, in treasury that works around public bonds.

And on slide 11, we can see a breakdown of the financial market on profitable assets when we compare credit and treasury. 6.95%, as you can see, slightly below the margin that we had in the previous quarter, already impacted by the interest rates and overdraft facility, that is not new. But the portion accounting for profitable assets under treasury has a higher proportion in terms of profitable assets.

If we were to leverage credit portfolio, and unlike other retail banks, credit for us has not grown. It will grow across different industries, but in absolute terms, it has not grown. Our margin would without a doubt be better. We are showing a margin at 15.3%, which ratifies what Marcus has just said, in terms of the Bank having two strengths: a capital structure, which is quite robust. A capital structure, which is almost made up of Level 1 capital and is ready to meet the Bank's liquidity demand, to move to credit operations, where we see the recognition of provision by the rolling out of our portfolios according to the rates of other clients. And also elements that try to identify or quantify the unpredictability level, which will be realized.

It has not been perceived in terms of credit quality. Ours remain stable, as I said, but that is a consequence of, once again, our portfolio has not grown, whereas for other retail banks, they see a strong growth, irrespective of the industry, not only renegotiating operations. Much of that provision is an anticipated result to other movements that might occur, especially coming from operations, which were renegotiated throughout this last quarter, which justifies this reinforcement in terms of provision, where increased by 63% in the months the provision expenses. And then, of course, it does have a very sensitive impact. But that, of course, kept the Bank from generating a better net profit.

Net income has also been affected by a higher tax rate. So all those elements combined, have an impact on the net income.

As for our portfolios on page 13, we see the profile of our credit portfolio, which we have renegotiated, both under individuals and companies. And we have the responsibilities that clients had pursuant which were renegotiated, account for 40% of the total portfolio. If we analyze only the renegotiated installments that represents around 2%.

And that appears on the screen, broken down in different lines, where we had renegotiations and whose effects have not been felt yet. And as the economy starts showing less bad, if I may, signs, this will be more than enough for us to be able to cover potentially default credits. So fund raising grew, it grows irrespective of other elements, and other credit lines offered by the government.

And Banrisul has not made news of any emergency resource provider. We have maintained our average cost, our term deposit, our main product have been maintaining an interesting cost for the Bank, which, thanks to free up margin, as we feel more comfortable to having higher leverage in our credit portfolio, this term deposit is concentrated around individuals, 2/3 of that portfolio are under individuals, and the remaining 1/3 under companies.

But we started to see that it is increasingly more favorable for us to move in terms of the deposit credit ratio. We need to better address that equation between good results to improve margins, to improve efficiency and the Bank's results.

The only caveat of that rationale is that right now, it is a more conservative time for the Bank, which is already more conservative in terms of growing portfolios as a whole, but the pandemic, the alternatives that the Bank offer to clients to allow them to work, we think the current reality allow them to continue to work without major problems. That implies that service revenues would drop. Even though insurance might grow, services tend to grow slower, especially within this new reality.

We realized that there is a higher participation in terms of bank fees at 48%, but there is also a drop in banking revenues when we have year-to-date in the half of the year, up 3%. Why? Because even though Banrisul cards contribute significantly to the final result. And it had a better result as it was seen, still, we see that because clients have been operating less within this new reality. Still, they diminish, they decrease their contribution, which was not added with the production of new insurance products, for example, and other services.

So we saw a small residual loss in terms of the participation coming from cards. But that is, of course, condition to the pandemic situation and the difficulty of working with those lines, those products. So that makes it more difficult for us to leverage other revenues, which are based on relationship.

But we have addressed that, and we are trying to work around that, and the result can be seen. We saw a drop of 5% in expenses in the half in the semester. In the first half of the year, we also have the impact of the renegotiation of wages, which happened in September last year, the collective bargaining. That is why we see a slightly growth in those expenses, but still lower than inflation, which was included in the collective bargaining, in the payrolling period.

As for the other, admin expenses, you saw a 12% drop. So the continuous search from more efficiency can clearly be seen. And this will continue to be so in the next moment when the economy resumes. So we are talking about a new and better reality for the Bank as we move forward.

And now on slide 17, we are talking about the margin. And the margin, of course, comes from that snapshot that we have in terms of assets. Assets grew by 9%. On the other hand, the credit portion which has a better spread for the formation of margin, they go back to a level, which is inferior to June last year. And inferior to June of this year, slightly below 42% under credit operations.

On the other hand, treasury today is no longer at 34%, which was the level at 12 months ago, but 42%. That comes from the growing fund raising, which is growing in real speed, irrespective of the freeing up of compulsory loans. But because of the allocation profile, of course, this is also affected talking about public central bonds.

Our credit operation with 41% of growth when compared to June last year. It is practically flat compared to this year's margin. And it has 2 main channels. I was just talking about it today, the agriculture front, our specialized portfolio for agricultural clients. That's 1 of the elements that have helped the portfolio to grow by 6% year-on-year or 12 or 2% in the quarter, but that also saw a drop when we compare that to December, not in relation to the June last year, because we had a slight higher growth.

But it is concentrated on individuals, not companies. When we saw the breakdown of our credit portfolio, we saw that 60% of our credit assets under individuals. Out of those 76%, 77% are under payroll loans. That, of course, shields our credit portfolio. Of course, we do have lower fees when compared to last year, but they remain stable. And they will allow us to grow.

And on the next slide, we will see what kind of growth we are talking about in terms of payroll loans. They allow us to have some margin gain. But for corporations, we are still limited to support operations, not so much in terms of growing the portfolio in a more robust way. It is more geared towards gaining share.

Payroll loans has its main segment, the INSS, in other words, the Bank generates credit, which corresponds to 49% of its payroll portfolio across Brazil, irrespective of the channel be it through bank's branches or banking correspondent.

That credit is a very good quality, very resilient at a time where our credit is not growing. And it also consumes less cash. And then the 32% in terms of payroll loans, the same level we had 12 months ago, and the state INSS portfolio, also another important portfolio. Those two portfolios have been growing year-on-year.

Total payroll 8.8%, an impressive growth, especially if we consider we have not exposed the Bank to risk. 8.8% for the total payroll portfolio. That is the Bank which is more regionalized and offers a lower risk credit when we compare that countrywide. And the clients of the Bank at 8%, at a speed very close to the total payroll portfolio.

The provision balance, of course, would need to have a portion of the credit portfolio. Today, we are 8.3% after the credit portfolio provision because that when first it is not coming from our main portfolio.

But coming only from that portion from the corporate portfolio, where we have higher default level when compared to the individuals. Because the measures today offer to mitigate the impact of our clients in terms of providing liquidity, maybe have not been addressed well enough or identified in line. Maybe we did not have to make those reinforcements. We do not know. We have to analyze the risk as per clients, with risk as per industry.

But when we compare with the rival banks, 7.6% we have for provision, we are already above the average of the retail market, which came to around 6.1%. The bank has always shown a growth.

But in terms of balance when compared to the total portfolio, it has been more conservative. And we continue to address the elements, we just mentioned, which, of course, affect our results because we do recognize the provision expense. We observed a slight differentiation in those 3 main debtors, a default but they are meaningless when compared to the remaining of the portfolio.

Our main debtors represent little when compared to the total. So 88% of which 11.7% until 4.6%. We are talking about normal risk level portfolios. And the other risk is slightly higher, which also ratifies the provision, which is slightly above the average of the industry, as I said.

As for the Basel index, we are made up by Level 1 capital, 15.1% of Basel is level 1 capital. So we are trying to preserve capital equal to leverage credit businesses.

And then the last slide is where we have a summary of the main methods of the Bank, where we see that because of everything which was presented, the return on equity for the Bank, today is slightly below 10%.

The asset quality is similar to what we had 3 months ago. Similar to December also, we could not compare that with 2019 because we were in a different moment, with more predictability in terms of credit, but the Bank's cover rate, which was lagging when compared to other banks. At 345% we had last year, that level was above the industry's average today and is adequate to the Bank's profile. So we are merely adjusting the risk presented by current clients, adjusting them to our provision needs. That is why you need to increase that cover already.

Our recovery rate was below. We did not need to get something too close to R$300 million or R$270 million as other banks have reported. Because it is totally fitting to the size and type of our credit portfolio. As for efficiency, we are now at a similar level as we were 3 months ago, slightly below, with what we have in December, and it's worse than it was in June last year because of the fact that we did not generate other results, especially in terms of services, as I mentioned, to be able to leverage that number. And as I reflect, we are close to 96% of our payroll today that work from personnel.

That is the last slide of the presentation. I have been spoken at length, and no I will give the floor back over to our analysts for questions that you may have. Thank you.

Sofia Viotti, Bradesco BBI:

Good morning. Thank you for taking my question. Could you please explore the mix of company sizes in your portfolio, just so we can see where they are more concentrated, to have a better idea of the quality of the portfolio? Thank you.

Osvaldo Lobo:

I can try and start answering your question. Basically, the Bank has a portfolio where it has R$36 billion. In this portfolio, what we have is a higher participation of higher companies or larger companies in terms of personal credit. We have a more balanced portfolio from the historical point of view. The core portfolio is a place where we have tried to reduce our participation in the past few years, and the strategy is to focus especially on small and mid-sized companies.

Sofia Viotti:

Thank you.

Yuri Fernandes, JPMorgan:

Thank you. Good morning. I have a question about renegotiated credit. Some banks have it at 14% in their portfolio. I would like to understand the criteria. Are you including in that number only Febraban's indication where you include different types of credits, longer default and so on. As of early March, what was the situation? In a nutshell, I would like to understand those 14%. And how is that moving forward, both in terms of quality? I am not really sure about the grace period. Is it over? Are you already collecting it? But if you could give us some color on the evolution of that, will be interesting. Then I have a second question.

Osvaldo Lobo:

I think I can address part of the question. And then my colleagues might jump in and complement if they feel like it. Both in terms of the Phase I and II of renegotiations, we have always focused on what we call the good clients. And the idea was to offer some relief to those clients and trying to maintain that good client status in the short to mid run.

So the renegotiations were not offered to those who were at default or those who we work without valid merits with higher problems. We have always focused on those clients to do it in a more strategic part and trying to consolidate those contracts with the best possible guarantees. In the first phase, we provided a 2-month solution, 2-month relief, something very similar to what was firstly offered or required by Febraban.

Then on Phase 2, we increased that relief period to up to 6 months, but also taking into account if those clients were already using the first 2, they only had 4, and then without grace period. The renegotiating phase, as we called them, closed early this month. And it closed because there was a drop in demand, which was, as we see is an intelligent positioning in the last month, if I am not wrong, in the last month, July, at R$7 million in renegotiation. In other words, the number was dropping by itself.

That is my personal opinion. I think it is better to concentrate not because of a counter as a whole because this will happen before or after.

Looking at the installments, we think that, that renegotiation had as its purpose to increase the likelihood of receiving in the future, but we only find that out when that term expires, and then we will have more information. But we have always guided those alternatives towards clients who had better limits, who were not at default. And lastly, we did not freeze provisions. We continued to make provisions as we thought was necessary and consistent with those clients.

Yuri Fernandes:

Okay. So your focus was on clients which were not at default. When we see an improving default levels, so was we make it with them, right? Because you were renegotiating early on March, April. But my question was, if those 14% included clients at default, but I understood no clients at default. Correct?

Osvaldo Lobo:

Yes. I am pretty sure that is what it is. That was our guideline. We focus on clients who are not at default.

Yuri Fernandes:

Okay. And the second question is about your digital channels. You showed a slide showing the number of transactions and the bottom growth. I would like to understand what has the Bank been doing to try and monetize that channel? What are the products that you have through a cell phone or computer. 75% of transactions. Has to do with, for example, checking the limits or checking bank statements.

But in terms of credit origination, what do we have, what kind of credit can be originated or is being originated through digital channels? It would be nice to know. And if you want to talk about some future projects, new products coming forward in terms of digital, that would also be nice.

Marcus Staffen:

Yuri, today, in digital, a vast majority products have to do with insurance and even our investment portfolio, everything can be made through the app, in terms of credit cards, it is also wallet, the app is very rich in terms of credit card services. Several different functionalities for that.

As for credit granting, we can anticipate the 13th salary, income tax payments with the anticipation of the guarantee fund for workers in Brazil, that also has been launched by the app.

For payroll loans, in this case, it is restricted to our state workers. And the credit origination for that is still small, not more than 20% of our total payroll loan portfolio.

Maybe Osvaldo will have something else to add in terms of digital.

Osvaldo Lobo:

I think there are two things that are worth mentioning. Number one, the project of a digital product, which we plan to conclude in August, this month. It is revolutionary say from the point of digitization, modernization of the Bank. It is a process that took a lot of time to be completed. But because of the COVID situation, we were able to speed that up, this would be good for the Bank.

And also to Yuri's point, for us to be able to conclude our operations totally digitally, we were kind of tied down because we lacked legal parameters, legal definitions. And the way it was done today, we can address that topic in a much more expedited modern way, and we have a pipeline of deliverables and deliverables in the short term, the short run that will have all those new novelties, these new novelties. Thank you.

Yuri Fernandes:

Can I ask a third question? The quality of the PDD portfolio. From what I understood in your release, when we compare with other banks, your peers and bigger banks, you see that many banks provision high in the first and 2Q. You did not do anything in the 1Q, correct? 45% of your portfolio is linked to payroll loans. So it should be a very defensive portfolio, right? So what can we expect? You have provisions like less than other banks, but you have a more defensive portfolio. What can we expect for the second half? Is the peak going to remain in the 2Q? Or are you going to see different things come? I know it is a tough question to predict, but just to get the feeling at your end.

Osvaldo Lobo:

I ask myself that question every day. I will start addressing your question. And the short answer or technical answer, that is something we work on. And I do not look at what the market is doing. The second part of your question is how do we behave compared to the market? And I would like to ask Marcus and other colleagues to help me out here.

But looking at how we work, we have been reassessing models constantly. We have our own metrics, which we follow on a daily basis. And I understand we have a portfolio which is different, unique because of payroll or real estate or agriculture. But still we are constantly reassessing default levels, receivables, and as I said, we check those metrics daily.

And what do I mean by that? When we thought of anything that starts moving out of what expected, we have all provisions in place that we thought were necessary. And we continue to make assessments constantly with 2 possible scenarios, which do not depend on us only. If things continue to behave in terms of recovery as expected, it is one thing. Or if we have a second, third or fourth wave of problems today, we then would think what we think to be likely.

We understand that the provision we have in place is enough. We have been reviewing that daily, as I said, and we follow upon it very closely. And I know it is something which is of everyone's interest. And we can be sure of something within what we have seen out there.

We understand it is quite satisfactory enough to cover losses. If not expected or unexpected things emerge, we will be reassessing everything once again. But lastly, the new provision level, which was laid out or what we saw in the 2Q already reflects this new risk, which we are trying to address as best as possible.

Cláudio Coutinho:

In the first part of your question, you said that we were less provision than the others, but we have 8.3% in our portfolio. I do not agree with that statement. When we look at other banks, we are in a very good position in that respect. And considering that 8.3% is a very high absolute level and that 60% of our portfolio is under payroll loans and real estate with legal guarantees, it is quite well provisioned, quite adequate as I see it.

Yuri Fernandes:

What I meant when I said 60% is that when you look at the growth in PDD, you have to take into account the mix, of course. But in provision a growth of 60% when compared to 2019. And we see American banks doing 600%, Brazilian banks doing 150% to 100%, Peruvian banks doing 300%. Of course, the mix is super important. And that is why I wanted to get. How do you see that? I know the growth of the Banks is lower, but you have a totally different mix far from me to state that you are making a lower provision. No, far from it.

Claudio Coutinho:

We have to analyze the provision against what we have in inventory at the end of the day. So we need to really try to predict what kind of growth we are going to have. But even if we have an increase of 30%, 35% year-on-year, 6% on the quarter, that is less than what they did because they were under a different situation. But when you compare the numbers, we are in a very adequate position when you compare provision to what we have in inventory and stock.

Yuri Fernandes:

Okay. Thank you, everyone.

Carlos Gomez, HSBC:

Good morning. Two questions. Number one, are you in an adequate position, as you said, but you do not really know when you are going to feel default impacting your numbers, correct? When do you believe you have the right, a more precise understanding of default levels after all the renegotiations? Is it at the end of the year, early next year? When do you believe your numbers will reflect the quality of the credit?

And number two, late last year, you worked on the provision for labor suits, legal issues around labor issues. And then at the end of the year, you were working on legal reserves to address that. So if you could give us a picture about that, I would appreciate it.

Banrisul:

I can start answering your question by saying, yes, as Marcus said, we understand that provisions are adequate, they are fitting, and they reflect expected losses. A personal opinion of mine is that the 1H21 will be a place where that provision will be put into practice in a more emphatic way.

Carlos Gomez:

Okay. But what about the provision? So you believe it to be more normal next year. But when are you going to feel the quality of the assets or have a better picture, a clearer picture of the default levels?

Osvaldo Lobo:

We understand that today it is 100% adjusted to the expected performance. The expected performance as I see it. We are talking about the 1H21 to have a better picture.

Irany Sant'Anna:

Osvaldo, just to help you out in your answer, our models for provisions are also taking into account macroeconomic scenarios. Because we have uncertain macro scenarios, we have also included that in our provisions. So we already have an increase in provision expecting a slightly higher future default.

As Osvaldo said, we believe that we are already at the adequate provision level. As to the legal provisions, especially around labor suits, we also believe that our provision level is quite adequate right now.

And last year, we did have, as you mentioned, the reinforcement in terms of identifying circumstances, which are not that clear to us before, especially concerning class suits.

So right now, we believe that if there is an increase, it will be isolated, but the future flow should be down trending. I might have short-term hiccups. But in the mid to long run, we believe in a drop in provision, which were at R$100 million per year before last year. That number should drop as we expect to see a normalization of the legal risk.

Carlos Gomez:

Thank you.

Eduardo Nishio, Plural Investimentos:

Thank you. Good morning. I am going to go back to asset quality. I think it is important. Looking at other banks, and given that you already have 14% of your portfolio renegotiated, default has been dropping in several cases because of that renegotiations that you and other banks have been doing. In your case, however, you see a worsening default quarter-on-quarter, year-on-year. If you could comment on that evolution, what is getting worse, why?

And what can we expect going forward in terms of impact on provisions? I think the provision level is even more important, right? You just mentioned that we will have a peak in the first half of next year. You just said, which is the guidance for several banks. But if you could comment on the worsening of the portfolio and also the level of provision we expect for the next quarters.

Then also, I understand you made an additional number now, 6% quarter-on-quarter, slightly high number, but when you look at your cover rate, looking at the trends of that default levels, one would expect that the provision level to continue high in the coming quarters. I would like to confirm that with you. Is that how you see it as a trend? We have default level going up, we will have provision going up as well. So if you please confirm that to me.

Irany Sant'Anna:

I can start and maybe Osvaldo might jump in and complement my answer. Number one, as we have already reinforced, provisions, the macroeconomic scenario being adverse led us to increase that as we defined, and we considered industries and sectors which have been more affected. So that number is already high.

The second point, which is quite positive for us, is that under the dynamics of our operations, early on, in the first renegotiation process, we offered two installments, 60 days, in a broader way so that our clients could have some relief, see the dust settle down and try to recover. It was not expected for everyone.

After that, and we expected the situation to linger, we had the renegotiation phase II, and we were talking about 36 months, six months grace period, but already with interest payments throughout the grace period as well. That read-back II, Phase II, to our surprise, saw very low demand, which is a good indicator for us, because 60 days for REPAC 1 had elapsed, so most clients were already back to normal, following the payment flows.

So our expectations are that the impact will not be as big as we had anticipated early on. Maybe Osvaldo would like to complement.

Osvaldo Lobo:

I agree with you. It is important to say that we are constantly reassessing the need and making provisions, considering all the uncertainty that we have in the scenario. With the current level of uncertainties and with the performance presented by the portfolio, the default level we saw, without that, we understand that the provision levels are adequate, as it was said.

Alexandre Ponzi:

Just as a complement for the first question from Nishio, our default level would be going up and other banks going down. I dare say it is the opposite or at least to say that our default is within reality, adequate and relatively stable. Our portfolio when we look at it, and it is important to analyze 2020, comparing with last year is of no use.

The expectations, the quality, everything was different. So the Bank has not grown. We saw a drop of 0.6% when compared to December. So the average of the industry for retail banks, excluding Banrisul, if I take the five larger banks, and Banrisul is not in that group, had an 8.4% growth of consolidated portfolio. If we analyze individual credit portfolio, ours has seen a growth of 5.1% from June last year. The average of the sector is 10%, some banks grew by 13%.

If we look at the corporate side, that relationship is even worse. And then it is a matter of different exposure to different segments when compared to the asset structure. Corporate credit, there was no change when compared to last June. The average on a bank is 23%, which sped up, especially the first half of this year.

So there is an element. There are operations which are working to defend our numbers and identifying risk elements and also providing benefits in terms of short run default. I hope this is exactly the result we will see in the future.

But it does not show a deterioration that might come when we have no grace period in place and that unprecedented elements are different from those identified now. They provide the Bank with comfort to say that the current provision volume, which, of course, hinders our results, they might not be worse going forward because the elements we identify might provide some relief for us to be able to move forward more seamlessly.

And the Bank has worked with the client, but we have not grown our credit portfolio that fast, especially when we had possible exposures increasing and talking about our corporate.

And that makes a difference when we compare default levels across banks. But in our view, default and provision for default, the size of credit portfolio and the cover rate that we have, all of that is totally in line.

That is why our cover rate rose less than others because our portfolio has maintained a very similar profile as to what it had last December and last June last year. We grew slightly in corporate. And it was what we expected to increase businesses with time, but it is founded in some structures, which is necessary for us to remain to gain share, agriculture, for example, and other lines as well. Lines to renegotiate and also to provide support in a difficult moment. But again, I cannot agree with the fact that our default levels are worse off than the average market for retail banks. I do not see that.

Eduardo Nishio:

Okay. I understand that there are different effects. But still you had renegotiation processing and what we saw in other banks is a drop in default and a stronger growth in credit, some of them with 2 digits, but still as for provision, banks have been doing different provisions in terms of cycles. Some banks can say it is a one-off in this quarter. But for the other quarters, we will see normal levels. Most retail banks have been saying that the second half will still come on strong as a whole, not as strong as the 2Q, but strong as a whole.

To Irany's point, you said that the additional has been made. So we can expect a normal level of provision for the second half?

Irany Sant'Anna:

We are considering that we have the right level of provisions, but we are paying attention to all scenarios. It would not be prudent for us to believe we will have a drop in provision compared to the levels we have today.

The scenario remains difficult, but it is difficult to measure that. So some impact on results when compared to what we had before COVID, we are still going to have, we are still going to have. But we do not expect surprises in what we consider what we are going to call the new normal.

There are sectors which are more highly impacted. They are not having the same level of revenue. They have cash problems, we know that. We are trying to identify that and work around our model to address them.

Our balance sheet structure, where we have expected loss for meaningful products is lower than other banks around real estate credit, payroll loans, which account for over R$20 billion in our portfolio.

We also have an important space in agribusiness, where we do not have that tight cash generation issue. We at Banrisul, we are having record prices in terms of soybeans, which is the cash cow for our agribusiness sector. So we are paying close attention to that.

And we do believe that the provision level will remain at a higher level when compared to before the COVID situation, but we do not expect a more severe worsening than that. We do believe that with the current provision levels for the past three months, we will have an adequate balance sheet at the end of the day.

Eduardo Nishio:

Okay. Thank you.

Tiago Binsfeld, Itaú:

Good morning. I have two questions about fundraising, especially in the deposit entry. We saw market growth in the 2Q, slightly below the market average. And you showed that in your market share data, in your earnings release. I would like to understand the dynamic of that lower growth? Is that the result of a strategy that you put in place? Or is it because of the market?

And number two, as to administrative or managed resources, R$12 billion considered in your balance sheet. If you could give us some more color on where those resources are allocated. Is it fixed income? And if you believe there is more room to reallocate those resources within the Bank?

Marcus Staffen:

About the first question, it is important to emphasize that given the time lag in terms of information, the market share we showed in our earnings release reports data from March.

So it does not reflect the growth in deposits in the 2Q as a whole. It is also important to say, you compare it with other banks, the Bank already has a higher percentage of CDBs, especially CDBs, and we were repaying lower volume of resources under funds. So that process of migration of assets, that was done in a lower volume.

Also important to mention, as I have given the characteristics of our fundraising activities, the liberation of compulsory loans also will help our liquidity level. The credit deposit ratio shows that and gives us some comfort, some reassurance. And there is no pressure whatsoever, so much so that even with the Selic rate at the current levels, when we think at a percentage of CDI, it makes increasingly less sense. And so we have no additional pressure in relative terms. And I think that addresses your first question.

As for the second question, managed resources, R$12 billion, as we said, no more than 3%, maybe something close to 5% in variable income. In other words, 95% are under fixed income funds. Another breakdown which might be interesting is that 1/3 of the products are under our own municipal pension funds, where we have a very strong operation.

That is a market that changes dynamically, but it is less affected. Having said that, considering your question about what we can expect going forward, we have been working with partnerships to perhaps possibly distribute third-party products, complementary products, complementary to our current grade, which is focused on fixed income products.

And we imagine we will be able to service our clients really well. At the same time, retaining those resources in the Bank. I hope I have addressed your questions.

Tiago Binsfeld:

Yes, you have. In terms of your expectations for a date to launch those third-party resources, do you expect this for this year or next year?

Marcus Staffen:

This year. We expect to have that this year, third-party products.

Tiago Binsfeld:

Thank you.

Marcus Staffen:

Since we do not have any other questions on queue, on behalf of Banrisul, I would like to thank you all for participating. And we remain available with our IR team, myself as IR officer, I remain available. Please do not hesitate in contacting us. Thank you very much and see you next time. Have a nice day, everyone.

Operator:

We now close the Q&A session. Once again, questions which have not been addressed during the call will be answered at a later date by the Bank's IR team. Banco do Estado do Rio Grande do Sul's audio conference is now over. Thank you all for participating, and have a nice day, everyone.