International Conference Call
Banco Pan (BPAN04)
1Q23 Earnings Results
May 4th, 2023

Operator: Good morning, ladies and gentlemen. Welcome to Banco Pan's earnings call. We'll be presenting results of Q1 2023.

The audio and the slides of this earnings call are being broadcast simultaneously over the company's IR website, at www.bancopan.com.br/RI and also through the webcast platform. This presentation can also be downloaded.

All participants are in a listen-only mode during the company's presentation. We will then have a Q&A session. Further instructions will be given then. If you need any assistance, please press *0 for an operator.

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We have Mr. Carlos Eduardo Guimarães, Banco Pan's CEO, and Mr. Inácio Caminha, Head of Investors Relation and Collections, are here with us today.

I'll turn over the floor to Mr. Carlos Eduardo Guimarães for his presentation. You may have the floor now, Sir.

Carlos Eduardo Guimarães: Good morning, everyone, thank you for attending yet another earnings call.

Let's start on slide 2. We have stable results despite a still challenging scenario. Our strategy has been conservative as far as credit origination is concerned focused on collateralized products. We originated only 1% of credit in the quarter, we have expanded our B2C origination, we had improvements in the customer experience of our app on top of the growing marketplace with Mosaico and Mobiauto integration in our channels.

On to slide 3, we have 25.2 million clients, more than half have some credit exposure with us. We have reached 39.3 billion of credit, our quarterly income was 193 million, ROE was 11.6 per year.

Next slide, please. We now have our business verticals, let's start with vehicle financing. We have boosted our production in the quarter with a better *ex-ante* profitability, we've had excellent experience, it's a simple product and the contracts are strictly conducted. Looking forward, delinquency levels are going to be above historical level not only for the bank, but also for the industry, and we hope that our profitability is robust because we have the proper pricing for that risk.

Second vertical, payroll loans and FGTS. ROE is stable despite the interest rate decrease. We hope to expand our B2C origination for these products.

The third vertical, we have been very restrictive not only in origination, but also in the limit management, we have drastically reduced our exposure in that segment. Looking forward, we expect an important evolution as far as experience is concerned and a dramatic reduction of PDV expenses throughout the second half of the year.

The fourth vertical, credit assignments. Profitability at expected levels and we'll keep on striving for diversification with new counterparties.

On to the next slide, this is our outlook for the year as the bank as a whole. We expect to expand our net due to a small reduction in delinquency rates and the gross spread, we're going to expand the B2C channels in our origination, we'll remain conservative as far as credit origination is concerned focusing on collateralized products, we're going to have cost efficiencies, we will be integrating our products into channels even further steering our customers to the app, and we'll have important progress in our transactionality experience, we'll be looking for recurrence and recommendation.

I'll turn over to Inácio now, he'll give us more details about the figure.

Inácio Caminha: All right, moving on, let me give you some update on our customers and our business lines. Onto slide 7, we see that UX improvement not only on our channels, but also on our products, generating even more engagement. As you can see on the chart at the bottom, total clients there was a 30% increase for the year, 25.2 million clients, the activation level is on an upward trend despite restrictions in the credit card arena, as Cadu said, cross-sell index remains stable at 2.1, but we also believe that it's going to grow throughout the year, just like we've seen in the Pix keys that started the year on the growing trend reaching 7.4 million purchases, and our Pix has a very differentiated experience when compared to that of other banks.

Transaction volumes we are at 22 billion for the quarter, there's a natural seasonality of the first quarter, when you look throughout the year it was a 12% increase.

On to slide 8 now, this is some detail about retail origination, we remain conservative, reaching 7.6 billion. The highlight is vehicles and the workers compensation fund, 3 billion for vehicles and workers compensation fund 1.3, payroll loans we had 1.3 billion for the Q4 and there were 2 weeks with no origination at the end of March when they were discussing the ceiling for that rate.

This is the breakdown of our credit portfolio, a very collateralized portfolio. Vehicles amounting to almost 18 billion, that's the largest portion, a little over above payroll loan and FGTS at 17, a 45% increase, and credit cards reached 3.13, almost 3.2 billion, a decrease of 18% for the year as a consequence of our strategy. The fall was even further reaching 39.3%, an 8% increase in the year. We remain growing always focusing on collateralized and more profitable items.

Delinquency rates, the mix on the left we have a growing trend in vehicles, we are only at 9% of clean credit when compared to 91 with collateral, delinquency above 90 days the indicators are aligned with the previous quarter and the 15-90 there is an important seasonality element there, it's always up in the first quarter and then it gives off throughout the rest of the year.

On to slide 11 now, this is a breakdown of clients with credit. Over half of our clients have this product, reaching 13.2 million. That's a growing trend, up 23% year on year, and this is a very important metric based on collateralized products.

Services, on to slide 12 now, we are at a very important level, Q4 is usually stronger due to Black Friday, boosting revenue from our marketplace. However, this first quarter we have expansion of other fees, basically from vehicles that have boosted that portion of services revenue. As far as credit cards go, it's on a downward trend, you have impact of more generation in Q4 of benefit cards and smaller transactioned volume in the first quarter, as we're going to see in further detail shortly.

Insurance, on to slide 13, premiums increase, we have higher penetration as well, there's important ratio with vehicles, workers compensation fund (FGTS) is expanding too and we have sold more insurance in the payroll loans as well, so the customer base with active policies reached 2.4 million, up 71% in 12 months, and premiums are up by 50%.

Let me know talk about the marketplace, onto slide 14 now. Our strategy is to focus on revenue with higher take rate, we are at 65 million even with the smaller GMV and we have been working hard to integrate Mosaico and Mobiauto, and in the second quarter now we're going to have the best shopping experience in a bank app, and that's because we're going to include every benefit we have; price comparison, historical prices, and warnings that are available within Mosaico, it will be also available in our app, everything integrated with that credit facility. So, this is going to be a very important lever to continue to engage our customers and showing them how important our services and products are.

On to slide 15. Now credit cards. We can clearly see that restriction that is started in Q4 of 2021 bringing that number down, quarter after quarter we have been reducing the number of new cards, but just like Cadu said, that's not the only front where we operate, but also, we have been working on the limits of our current customer base.

On the right, you can see the first quarter has a smaller TPV bought because we have more restrictions, and revenue reached 66 million when we look at cards alone.

Now let me talk about the other marketplace, Mobiauto. We have very positive numbers from the platform that has helped in the vehicle’s origination, Mobi add value not only with shop owners, but also our customers. That journey is very homogeneous, we've already talked about Mobi Já, it's a very nice experience for individuals that want to sell their cars or easily connecting to several shop owners, that's very simple, that's very easy. We already have 7.4 sellers operating with us, an 85% increase in 12 months.

When you take into account the percentage of origination of how many of those clients that financed the car went through Mobiauto, we are at 5.2% combining motorbikes as well, we have a total of 224,000, and in the quarter, revenues amounted to 16.3 million from this company of our group.

And now in May we're going to have a promotion that is very interesting bringing benefits to customers, and we will be able to engage these customers even more and also the sellers.

The financial highlights now, that’s slide 18, that's our net interest margin. The total margin reached 12.8% due to higher volumes, but when we take into account without that session, we are at 8.7%, a very robust number.

On to slide 19, these are the top lines or the highlights. We are at 1.9 billion of financial margins, that's the total, 18%, when compared to the assets. If we were to exclude, we are at 13.7, which is also a very solid number. When we take into account PDV revenue, we have an improvement that's being brought down to 4.9-4.82 million, that's the nominal value. There's another effect that will be accounted in other expenses, these are higher discounts, they're not going to be included in this line, but they'll be matched in other lines and there are other interesting opportunities to keep customers closer, those that we deem valuable we want to be able to continue to offer more credit, more services down the road.

On to expenses. The highlight here we had less expenses, but due to less origination in the quarter, origination expenses are down to 553 million when you look at the bottom line. Adjusted net income was 193 million, ROE is 11.6%.

And to conclude this first portion of our call, we have the capital slide. We are at 15.8% on the quarter, that's the equity, that shows how resilient the business is, how capable it is to grow and to leverage the operation to generate even more businesses with our clients.

That concludes our presentation, and we can now start the Q&A session.

Question and Answer Session

Operator: We will now start the Q&A session for both investors and analysts. If you would like to ask a question, please press star 1. If your question is answered, you can remove yourself from the queue by pressing star 2.

Please, wait while we collect the questions.

Pedro Leduc, from Itaú BBA, asks the first question.

Pedro Leduc: Good morning, everyone. My question is about payroll loan origination and profitability. When you originate on a quarter-after-quarter, there was a turbulent quarter, the end picture is that origination is at 40% would be 2.5 billion. Now we have an intimated cap that has been defined, I would like to better understand whether we can go back to original levels, origination levels we had 3-4 billion by quarter or is it something along the lines of what we've seen recently, 2 to 3 billion?

Of course, origination and you have to take into account profitability, how did you manage to manage that balance? You still have good ROE, but you would have to cut commissions by half. Does that make sense?

We would like to see originate and consigned loans go up because you had more cessions than originations so that you could sustain that on the long-term. But I would like to understand that flow profitability, commissions, originations, what's your take for the quarters to come? Thank you.

Carlos Eduardo Guimarães: Good morning, Leduc, thank you for your question. As you well know, the consigned was from 2,13 to 1,97 in late March, we offset, we actually have 2 origination channels: one is B2B and B2C. In B2C, we adjusted, and we were able to be more effective in our marketing expenses to attract customers –that's for B2C –; and in B2B we brought the commission down. To what extent? It was something like 11% commission for the flat and the installments is now 8% not only for Pan, but also the industry as a whole. That commission level, about 8%, it happened in the past, as soon as we adjusted the commission of course there was some reduction in the origination, but what we expect is that we are going to go back to similar levels of origination that we had in the past, about a billion of consigned, about a billion a month.

In April that didn't happen, the wheel is beginning to turn I would say, but I truly believe that we're going to go back to these origination levels.

Our profitability given these optimization exercises, we believe that the product will have attractive profitability levels, will remain competitive from now on. Of course, we have an internal challenge, we have been addressing it already, we want to have a bigger mix of origination in B2C, maybe 50-50, and that's going to help us as well in that sense, not only in terms of profitability, but also in terms of diversification.

I think I've addressed everything; origination, probability, how we adjusted in both B2B and B2C, and we do believe it is a profitable product, good for clients too, and it's going to grow in the quarters ahead.

When we compared numbers to Q4, we had to address the lowest issue, you could have consigned loans for loans, that payroll loans, but that was canceled. However, discussions are still pending and there is a possibility to return payroll loans to loans, and that will help us bring our levels to go to a billion a month.

Inácio Caminha: In that delta from Q4 to Q1, we had R$1 billion from *Auxílio Brasil* that is part of that 5 billion you see in Q4 on top of the *Cartão Benefício,* which was stronger in Q4 because it started in late September and impacted both Q3 and Q4, now we're going back to normal.

Pedro Leduc: Thank you, Inácio, thank you, Cadu. Congratulations for navigating through this turbulent quarter.

Operator: Olavo Arthuzo from UBS is up next.

Olavo Arthuzo: Good morning. I would like to address the delinquency rates, above 10 bps, up 7.2, and PDD was down. What can you tell us about the NPL peak? Was it the peak in Q1? Are we expecting anything different in the quarters to come?

Data indicates that we are close to that NPL peak. What do you expect things far as trends are concerned? Thank you.

Carlos Eduardo Guimarães: Thank you for your question, Olavo. Let me talk about the bank's businesses and then I'll combine all of them to talk about the bank as a whole. Number one, cards. We have been reducing the issuing of cards, our PDD expenses remain high, and we are convinced that the PDD expenses for credit card in this year will decrease, in December will have less than half of the average PDD expenses in Q1. This has been contracted out basically, we have better origination, reducing limits and with the more troublesome customers, so we're going to ring that PDD expenses down. It's currently underway and we believe it will be effective. That's for the credit card business.

Payroll, workers compensation fund, loans, *Auxílio Brasil* these are other types of risks, it's not the traditional risks, so it's under control, it's been so for quite some time, and we don't envision any hiccups along the way, including for the *Auxílio Brasil* that is completely aligned with what we expected when we started the operation.

And finally, vehicles. We keep on expanding our vehicles portfolio, we're excited about the profitability in this segment, it has always taken into account the active rate, the funding, costs and PDD expenses. So, we always look at the ROA language.

The delinquency indicator for vehicles is higher than pre-pandemic levels, but we have already priced that risk, so we remain comfortable to increase that, that's why we've done so, and given the signs or the maintenance of the current level, PDD expenses are absolute and at the same level.

When we combine all this, we expect fewer expenses in the quarters to come. Driven mostly by credit cards and vehicles, the level will remain above previous levels. However, we will be very well-protected by the margins we have stablished.

Olavo Arthuzo: Thank you, very comprehensive. if I may, I'd like to [inaudible] about the capital structure. You have been expanding, it's up 20 billion, 15.8. What can you tell about dividends distribution or share buyback plans? Or what would be the appropriate level for the bank? Thank you.

Carlos Eduardo Guimarães: The base scenario, if I may, as far as capital is concerned, should be about 13% of Tier I and about 2%... from 12 to 13 for Tier I and 2% for Tier 2, but this is a more volatile environment, so that's why we have maintained very comfortable capital level 15.6. That will change depending on the scenario. The fact is we have available capital to address the growth we want to have provided the scenario is favorable. At times like these, we will keep on using capital conservatively, 15.6 Tier I this is very conservative capital.

There are opportunities to issue Tier 2, however, we're still considering that possibility for the time being.

Olavo Arthuzo: I understand, thank you so much, Cadu.

Operator: Gustavo Schroden from Bradesco BBI asks the next question.

Gustavo Schroden: Good morning, Cadu and Inácio and Rafa. Thank you for taking my question. My question has to do with results and drivers. It's clear to me that the bank has shown PDD decreases as you have stated before, and results are strong from your portfolio, that has helped and I am in the quarter without credit it's been coming down.

Despite PDD is coming down and I am selling portfolio, was robust, bottom line remains at 190 million. I was looking at the model, since Q1 2021 profits remain at the 190-195 million level. What's missing? What's lacking for that profit go up even higher?

If you look at the NIM trends considering selling portfolio that expanded fine, PDD is coming down fine, but there were some expenses that were slightly above, pre-tax profit is coming down too quarter-on-quarter, year-on-year. How can we interpret these drivers? What if they improve and however earnings power remains somewhat impacted the way we see it at least.

Carlos Eduardo Guimarães: Thank you for your question, Gustavo. I would like to summarize that into 3 points: #1, we are suboptimum in costs. Let me remind you that we invested heavily in 2020-2021 in our banking, in our transactionality, and given the macroeconomic scenario, we decided to reduce our imagination drastically in our credit card portfolio, something that is very important to engage clients and to transform everything into investments in banking and into profitability ultimately. So, that was our decision to postpone, so we made that investment, so that's why we remain suboptimal as far as profitability goes in the banking area.

And within banking, we have credit cards that have impacted our results dramatically. As I said before, quote on quote, we had a PDD reduction that has been contracted out and we are very convinced it will happen throughout the year, so this will be an important driver to improve the bank's results.

Let me remind you that the credit card business is different, unlike no other. The other businesses, so customers that pay interest they balance out the results of the business as a whole paying for those that did not pay. In credit cards, you can only charge interest when customers or clients are in arrears, so it's a way more complex business to manage profitability, especially for medium-income or low-income customers given the macroeconomic scenario we have now.

We came out of pandemic with an all-time low delinquency, the government was injecting resources into the economy, customers didn't have to spend, so credit was fine. All of a sudden, 15 months later, 18 months, we had inflation of 14%, 15% a year inflation rates, their lives are way more difficult, and on top of that, there was a huge credit card offer in the market for people that do not have that financial discipline to deal with that supply of credit.

Looking forward, there will be a cleaning activity of that increased debt if you take Central Bank and remove credit card that remains flat for quite some time and all growth comes from credit cards.

In a nutshell, it is 3 points your question: #1 our credit card results will be a lot better as time goes by, next year will be clean of these PDD digestion we are having in credit cards. On top of that, we're going to issue new cards, we'll help in customer engagement, we'll transform our banking investment into something that is profitable, something we haven't had so far.

And finally, you had a business of vehicles in 2021, for example, we had a price and expected loss that was higher than what we priced at the start – that's for 2021. For 2022 onwards, we are now including higher rates, expecting higher delinquency rates.

So, these are the new seasons for vehicles, new stages that will convert into higher profitability. So, we are excited with the future, and as time goes on, results will get better, but will start next year at a different results level given these 3 reasons I've just given you.

Gustavo Schroden: That was very clear, Cadu. If I may, I'd like to follow-up on a comment that Inácio made about discounts. He was explaining the lower PDD expenses, and he talked about some discounts in other lines. Can you clarify those discounts? Are they related to overdue credits?

Carlos Eduardo Guimarães: Well, these discounts were between 30-40 million higher when compared to the previous quarter, and we are very conservative when we give discounts, we take into account 2 metrics: one, is it a long-term customer? Is it important to give them that discount to keep that customer? This is one approach. The other one is: if his or her credit situation is even tighter, they could return the car and pay off the debt and if we believe they'll be hurt, we'll get the car and we'll give them the discount.

So, we take into account these 2 approaches: customer view, whether we want to keep them or not, and if the customer is into deep trouble, they want to return the car, we accept the car, give them the discount, they are pleased and we are also pleased too because we believe that this amount we're getting here is bigger than what we would expect in the future given the fact that there is depreciation of the car, the customer's economic situation may deteriorate as well, so that's why we take into account that renegotiation/discount.

Gustavo Schroden: Perfect. Thank you, Cadu.

Operator: To ask a question, please press star 1. Please, hold.

Pedro Leduc from Itaú BBA asks the next question.

Pedro Leduc: Thank you. My question is about expenses with origination. It was down 13%, a little less than origination fall, about 20%, and we look in between the lines of origination, those with the commission [unintelligible] origination with the payroll loan was down 40. So, you saved a little less. I don't know whether there were other commissions to other lines or workers compensation fund or vehicles, other expenses was 20%, so there were less commission, but an increase in other lines.

What are the drivers behind those higher expenses? Is that larger share or reallocation of lines? I would like to better understand that experiences with commissions in the quarter.

Carlos Eduardo Guimarães: Thank you, Leduc. Origination expenses or the payroll loans is broken down in 2: one is flat and the other one is paid installments. Well, this flat is a direct relation of what was originated, there's some delay because origination expenses that we pay out in March refers to February, so there's a one-month delay. That's for the flat, we are at 8, once that ceiling came down, 5% for flat, 3% for those installments. And those installments is not a function of origination, it's a function of the portfolio.

So, there's that difference you cannot connect all commission expenses to whatever was originated in the quarter, either because there's that delay or you have commissions paid out in installments that came from previous origination. That's the first thing.

Inácio Caminha: Number 2, more efficiency coming from B2C. It does not generate commission, but there are other associated expenses.

Carlos Eduardo Guimarães: Leduc, the comparison we make here we have a B2B business in payroll and there's the B2C business. the main differences are number one, B2B is a commission, it's a variable commission; and in B2C you have personal and marketing costs. We look at the business differently, one is commission, the other is people plus marketing. Profitability, we take into account these 2 origination forms, and of course, when we diversify, it's way better for the bank. That's the role we're taking.

And B2C customers are more loyal, and they are long lasting than the B2B customer. That's how we look at the different businesses, the two different origination, and we're growing in B2C, and we are very excited that we're going to move on to a level in the B2C in the payrolls. For the workers compensation fund, 65% origination there is B2C already, 35 B2B. We want to get to that level in the payroll loans as well.

The message I would like to convey is that costs will be under control all the way to year’s end. We don't see any major costs increase, we want to have even more efficiency to have more operational leverage mostly because most of our investments financially speaking have already been made, they were postponed given the macroeconomic scenario, but we expect to have the benefits down the road.

Pedro Leduc: Since B2C is a commission, is it one-time payment or is it in installment too?

Carlos Eduardo Guimarães: In B2C, actually, we don't call it a commission. Okay, B2B you have an origination expense, it's a commission you pay to the banking correspondent in B2B. In B2C you have origination expenses that you pay to your sales force that you have within the bank and that's performance expense for marketing to attract, performance marketing/CRM sell payroll loans for our base, origination expense one is the commission in B2B and the other one is performance marketing, CRM, and salesforce, and that's how we make the comparison between the 2 origination.

Pedro Leduc: That was very clear, Cadu. Thank you.

Operator: since there are no further questions, this concludes the Q&A session. I’ll turn over the floor to Mr. Carlos Eduardo Guimarães for his closing remarks.

Carlos Eduardo Guimarães: Once again, thank you for attending our call, and I hope to see you in the next earnings call. Have a good day.

Operator: This concludes Banco Pan’s earnings call. Thank you for using Chorus Call. Have a good day.