

ISSUER COMMENT

27 February 2023



RATINGS

B3 SA. Brasil Bolsa Balcao

Lt issuer rating (domestic)	Ba1
Senior Unsecured rating (domestic)	Ba1
Outlook	Stable

Source: Moody's Investors Service as of 17 February 2023

KEY METRICS:

B3 SA. Brasil Bolsa Balcao

	Q4 2022	Q3 2022	Q4 2021
Pre tax income (BRL million)	1,380	1,363	1,475
Pre tax margin (%)	53.7%	54.3%	60.7%
Debt/EBITDA (securities)	1.5x	1.5x	1.7x
(Retained Cash Flow-CapEx) / Debt (%)	30.9%	28.3%	-11.6%
EBITDA (Securities) / Interest Expense	5.3x	4.5x	6.5x

Source: Moody's Investors Service

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B3 S.A. - Brasil, Bolsa, Balcao

Revenue went up driven by trading volumes, but expenses led results to decline

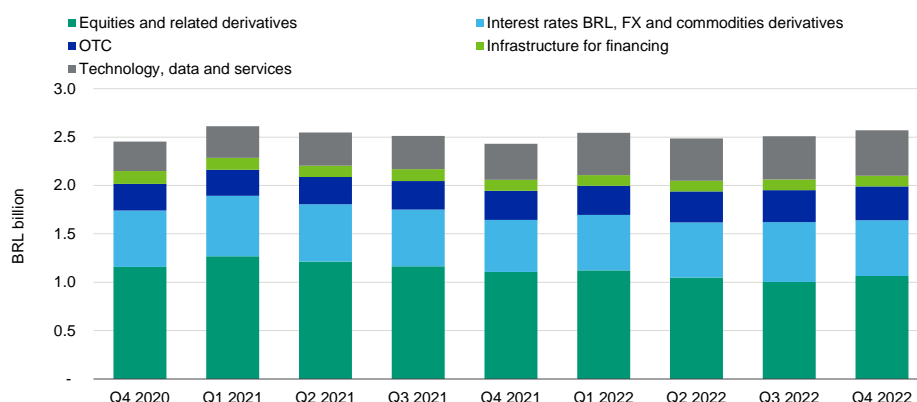
B3 S.A. – Brasil, Bolsa, Balcao's (B3) reported credit neutral fourth-quarter results. Cash equities was the main driver for growth in trading volume in the listed segment, with the volume of foreign exchange (FX), interest rate, currency and commodity (FICC) derivatives stable. Trading volumes of cash equities in the fourth quarter of 2022 improved significantly from the previous quarter, reflecting a scenario of increased volatility around the presidential election, following two quarterly decreases sequentially. Average daily trading volume (ADTV) in B3's cash equities and equity-related derivatives reached BRL32.3 billion in Q4 2022 from BRL26.2 billion in Q3 2022, a 23.4% increase (QoQ). However, annual ADTV decreased 11% in 2022 compared with 2021 because of high interest rates and low attractiveness of equities. Average daily volume (ADV) in interest rate, FX and commodities remained stable in Q4 2022 at 4.5 million contracts a day and dropped 3.5% annually, mainly due to a decline in ADV from interest rate BRL contracts. Revenues per contract (RPC) fell 2.9% relative to Q4 2021 and remained stable year-over-year.

Earnings originated by the listed equities division increased 6.1% in Q4 2022, from the previous quarter, and decreased 10.9% annually, reflecting lower trading volumes and margins. Revenue from the listed derivatives division went down by 6.7% sequentially and remained flat from one year prior. In aggregate, these divisions represented 64% of B3's overall revenue in December 2022 (exhibit 1). The quantity of individual investors in B3's equity division increased 37.1% annually and reached 4.5 million in the fourth quarter.

Exhibit 1

Diversified earnings generation in Q4 2022 supported a stable quarter

Evolution of revenue breakdown



Source: B3's financial statements

The high interest rate environment benefited the OTC segment. Higher issuance volumes of fixed income instruments, particularly bank deposit certificates, impacted earnings that grew 5.7% quarter-over-quarter and 13.4% year-over-year. The Treasury Direct, a platform that allows investors to allocate resources into government securities, further diversified revenue generation and performed well in 2022.

On the other hand, the modest macroeconomic scenario had a negative effect on vehicle sales, which went down 9% in 2022 compared with the previous year. This weaker performance contributed with a 7.3% annual decline in earnings from the segment of infrastructure for financing. These earnings accounted for 4% of total revenue in fourth quarter 2022. Revenue from the technology and data services segment (18% of total revenue) went up 4.7% in the quarter and 29% year-over-year, driven by an increase in customer base and the consolidation revenue from Neoway.

Adequate performance continued to support the entity's Ba1 rating. B3 reported pre-tax income of BRL5.8 billion for 2022, a 9% drop from 2021. In addition, its pre-tax income reached BRL1.4 billion in Q4, 1.3% higher than in Q3. The firm's annual pre-tax margin weakened to 57.2% in 2022, from 62.9% in 2021. On a quarterly basis, B3's pre-tax margin was 53.7% in Q4 versus 54.3% in Q3. The decline of the annual pre-tax margin in 2022 stemmed from a weaker performance of the listed equities division and higher operating expenses. Expenses were up 15.7% in the quarter and 20.2% on an annual basis compared to 2021, mainly reflecting extraordinary and non-recurring job termination expenses resulting from B3's efficiency improvement project, new hires, the addition of Neoway to this expense line and also lower capitalization of project expenses. Pre-tax margins haven't dropped below 50% since Q4 2019.

Leverage guidance was increased to 1.9x EBITDA for 2023. In 2022, B3's leverage was 1.8x recurring EBITDA, lower than the 2.0x in 2021. We consider B3's indebtedness to be manageable. EBITDA relative to interest expense, as calculated by Moody's, stood at 5.4x in 2022, a decrease from 11.2x in 2021, reflecting the increase in interest paid due to the high interest rates in Brazil.

Cash coverage, measured by Moody's ratio of retained cash flow (net of dividends) minus capex as a percentage of total debt was 35.2% in 2022, showing a rebound from 1.8% at year-end 2021, when a cash position was pressured by a high dividend payment that year. In 2022, return to shareholders reached 125% of IFRS net income. For the fiscal year of 2022, B3's total dividend payout, including interest on capital and share buyback, amounted to BRL5.3 billion. Guidance for net income payout for 2023 was adjusted to 110%-140%.

B3's capex guidance for its core business in 2023 is BRL180-230 million, following a capex of BRL201 million in 2022. The capex guidance for its new initiatives and businesses is BRL20-60 million, compared with BRL18 million in 2022. Both guidance for capex are in line with the company's plans to pursue operational growth in its core business and non-core activities. We expect B3's cash flow generation to remain strong in 2023 and, consequently, B3's leverage and coverage are likely to stay at levels commensurate with its Ba1 rating.

B3 has a strategy to diversify its revenue base with less market sensitive activities. In Q4 2022, B3 announced a BRL620 million acquisition of Neurotech¹, a company focused in Artificial Intelligence, Machine Learning and big data systems and solutions. This initiative was complimentary to the acquisition of Neoway at the end of 2021. These acquisitions in data and technology are consistent with B3's strategic plan to increase revenue from less market-sensitive technology, data and services, which represented 18% of total revenues in Q4 2022, up from 15% for the same period one year earlier. Like other market infrastructure providers globally, B3 plans to migrate its capabilities to a cloud-based infrastructure. This migration is a mid-to-long term project expected to take between five and ten years.

Rating Considerations. B3's Ba1 issuer rating is supported by its vertical integration and dominant position in its target markets as well as its diverse operations and strong operating leverage. B3 also operates Brazil's large and systemically important central counterparty clearing house (CCP) and depository. Ratings are positioned one notch above the Government of Brazil's rating (Ba2 stable), reflecting the fact that B3 has a strong credit linkage to Brazilian sovereign risk through its collateral holdings of government securities and the geographical concentration of its operations.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

Endnotes

- 1 B3 also committed itself to the future payment of BRL523 million in earn-outs, depending on the achievement of certain performance targets in the next four years.

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