Q3 2019 Earnings Call

Company Participants

- Joao Marcello Dantas Leite, Executive Officer, Chief Financial Officer & Member of Board of Executive Officers
- Roberto Balls Sallouti, Chief Executive Officer, Member of Management Board & Director

Other Participants

- Nicolas Riva, Analyst
- Tito Labarta, Analyst

Presentation

Operator

Good morning. And welcome to the Third Quarter of 2019 Results Conference Call of Banco BTG Pactual. With us today, we have Roberto Sallouti, Joao Dantas, Pedro da Rocha Lima. We would like to inform you that this event is being recorded and all participants will be in a listen-only mode during the Bank's presentation. After Banco BTG Pactual's remarks, there will be a question-and-answer session for investors and analysts when further instructions will be given. (Operator Instructions)

Today, we have a simultaneous webcast that may be accessed through the website www.btgpactual.com/ir in the platform. There will also be a replay facility for this call from November 5th through November 12th.

Before proceeding, let me mention that this call may contain forward-looking statements relating to the prospects of the business, estimates for operating and financial results, and those related to the growth prospects of Banco BTG Pactual. These are merely projections and as such are based exclusively on the expectations of Banco BTG Pactual's management concerning the future of the business.

Such forward-looking statements depend substantially on changes in market conditions, government regulations, competitive pressures, the performance of the Brazilian economy and the industry among other factors and risks disclosed in Banco BTG Pactual's filed disclosure documents and are therefore subject to change without prior notice.

Now, I'll turn the floor to Mr. Roberto Sallouti who will begin the presentation. Mr. Sallouti, please go ahead.

Roberto Balls Sallouti {BIO 4150617 <GO>}

Thank you very much. Good afternoon to everybody on the line. If you could please turn to page three of the presentation, we would like to start pointing out some of the highlights of the quarter. First thing, we would like to mention is that we had significant net new money inflows into Asset Management and Wealth Management in the quarter. If I'm not mistaken, this was another record quarter net new money for Wealth Management and our second highest quarter ever for Asset Management, and this contributed so that our assets in both of these business units continue to grow above 35% year-over-year.

Second point worth mentioning is the very strong performance by our Investment Banking unit where we had a record quarter in revenues, where basically, we are benefiting from the leading franchise we have and from the rebirth or growth of capital markets in Brazil as the country reaches all-time lows in interest rates and we expect this trend to continue over the next years, if not decades.

Third point worth mentioning is the very strong quarter in Sales & Trading where the business took advantage of the high level of client activity. This was a record quarter for us in brokerage for example and we also benefited from the benign trading environment during the quarter.

Qualitatively, BTG Pactual Digital continues to be recognized as best in class for its user experience and client service. It was just awarded the RA1000 by ReclameAQUI, a very renowned website on client service locally in Brazil. And finally, Banco Pan continues to show improvement in its operational performance, has also released results today, continues growing quarter after quarter, and Pan was successful during the quarter in the follow-on where it accessed both primary and secondary proceeds to basically to prepare itself for growth over the coming quarters.

On page four, we talk about the specific results of the third quarter. We had total revenues of BRL2.18 billion and adjusted net income of BRL1.07 billion. This gave us an annualized return on equity of 20.8% in the quarter, and the net income per unit of BRL1.23. For this quarter, our cost-to-income ratio was below our historical average, basically, as we continue to benefit from the operational leverage of our platform and continue to take advantage of the significant IT investments we have been doing over the last few years. So we finished this quarter with a cost-to-income ratio of 39% and a comp ratio of 19%.

And finally, we finished the quarter with total assets of BRL168 billion, a Basel II ratio of 15.1%, the most important part here is with the Core Equity Tier 1 ratio very, very close to 12%, and shareholders' equity of BRL20.8 billion. Over the quarter, we also paid distribution of interest on capital BRL624 million, had an average VaR during the quarter of BRL147 million or 72 bps of our shareholders' equity.

Moving on to page five. We basically show the numbers for the first nine months of 2019. We had total revenues of BRL5.85 billion and adjusted net income of BRL2.82 billion. This gave us a year-to-date annualized return on equity of 19%. Our cost-to-income ratio was in line with its historical average. We had a cost-to-income ratio of 41% and comp ratio of 22%. And during the year so far, our shareholders' equity increased 8.6%, finishing the period at BRL20.8 billion.

Turning to page six. We show the business areas distribution of revenues and we can see that it's pretty much even with the exception of Sales & Trading, which had a very strong year-to-date. Sales & Trading is less significant than the past, but significant. But what we really like here is that when you look at it from a more consolidated view, analyzing the cyclical versus the non-cyclical businesses, the businesses that use capital versus the businesses that don't use capital, we reached a very balanced division between the different types of businesses.

So 29% of business coming from client franchises, 36% of business is coming from Sales & Trading, 28% from Corporate Lending, Principal Investments and Participations. So we really like the shape that our business has taken. This is something that we've been pursuing over the last years and quarters and we're actually quite satisfied with where we are.

Moving on to page seven. During the quarter, we also transferred the capital usage of EFG to the Holdco. We have still not -- do not have all the regulatory approvals for the final sale. But we entered into an agreement where we transferred the capital usage to the Holdco. With this, we're just using regulatory capital in the Banco BTG Pactual core business and at Banco Pan. At BTG Pactual core business, we reached a return on equity in Q3 of 21.4%, and at Banco Pan, 13.5%.

With this, I pass on the floor to Joao Dantas who will talk about the performance of each of our business units.

Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Thank you. Thank you, Roberto. Thanks everyone. Good morning, good afternoon for our shareholders and analysts on the call. So we're going to go now through the performance of the business areas in more detail. But just as a starting point and to reinforce the comments made by Roberto, I think it's again our third quarter pretty much like the second quarter, is one of the ideal quarters where we have all the businesses delivering and hitting on all cylinders. And we're going to see the reasons behind that.

So turning to page nine, we start with Investment Banking. Our Investment Banking performance really reflects strong capital markets in LatAm, especially ECM and DCM where volumes have picked up more in the latter part of the year. We have finished the quarter as the number two franchisee number of transactions in M&A in Brazil and Latin America, and as the number one in number of transactions in Brazil for ECM, as well as number two in number in volume of transactions in Latin America for ECM.

Our B franchise is certainly the leading player in LatAm and certainly the number one franchise in terms of value creation for shareholders, reaching BRL281 million of revenues in the third quarter of ' 19 which is our historical record and much of all the typical revenue that we capture even in a very positive quarter. This is reflective of not only strong capital markets, but also the confidence of entrepreneurs and investors resuming gradually and we will be able to talk about that and the fundamentals for that throughout the presentation.

Turning to page 10, we have Corporate Lending starting with the graph on the right part which depicts the growth of the portfolio. We have reached BRL39.3 billion of Corporate Lending, which is a 15% growth quarter-on-quarter compared to BRL34.2 billion that we reached at the end of the second quarter of 2019. Year-on-year, it's a 51% growth of the portfolio and the drivers behind that growth are essentially three.

The main drivers, the growth of the portfolio in Brazil, Corporate Lending has been growing. We have been growing our portfolio with diversification maintaining credit quality. We are still disbursing credit for transactions that are ranked in the top two notches of the rating scale of Central Bank of Brazil. Therefore, maintaining the credit quality, we already have.

A second important driver is the growth of Corporate Lending in Chile where we are building up a strong Investment Bank and balance sheet. And the third driver is coming from SME lending. So similar to when we discussed Wealth Management, we already see the contribution from digital retail clients kicking in here. At Corporate Lending, we also see the contribution for -- from credit disbursement for small and medium enterprises, even though we still don't have a corporate banking and current account setup ready, we are still -- we are already disbursing some and all these three drivers have contributed to this 51% expansion year-on-year.

Our reserves level have increased year-on-year. Our results have expanded. So you see we reached BRL207 million of revenues in the third quarter, coming from BRL192 million on the second quarter and coming from BRL133 million here on the fourth quarter of 2018. So we have had less contribution from special situations revenues during the year, we had some in the first and the second quarter, but not on the third quarter, and also not in the fourth quarter of 2018, nothing relevant, even though the special situations book still also grows, but it's not accounted for on accrual basis, so we didn't have any relevant realization event that unlock P&L in that sense.

As we look at the portfolio and the level of reserves, we are quite happy and confident that the reserves are adequate. They have increased throughout the year, but they put us in a very comfortable position. As we look around to our competitors, we see some of them dwelling with some Corporate Lending situation, especially in Brazil. But it's not the case in our portfolio. Our portfolio continues to perform as expected with resilience in returns and resilience in the quality.

Moving on to page 11. Here, we have another strong quarter from Sales & Trading where we reached BRL801 million of revenues, below BRL886 million that we had in the second quarter of 2019, but still above historical average of that business. Certainly, we're capturing a strong performance from the benign markets environment where we see expectation from -- for inflation going down, growth expectation gradually going up. The approval of the pension reform and the expectation of other reforms to follow, and that -- all that leads to increasing confidence for 2020. So we took advantage of these benign markets in the third quarter to capture value once again in Sales & Trading.

We also see flows strong. We see strong revenues from secondary market conditions across LatAm not only in Brazil, but all our broker dealers across LatAm have been increasing and have reached a new plateau of revenues. We see also more volumes from flow trading. We believe this benign environment, at least from the perspective of the confidence of investors and entrepreneurs, should continue as we see a positive trajectory for the reform agenda and the steering of the economy, and we expect that to continue to attract business opportunities in Brazil especially and to boost our ability to deliver revenues here in Sales & Trading. In terms of balance sheet usage, we're now in a downward trend. So smaller positions and smaller VaR as a percentage of equity.

Turning to page 12. Here, we see Asset Management and there is -- it is a very good quarter for Asset Management. We start on the graph on the right part of the page. We have reached BRL253.9 billion of AUM which is a historical high for Asset Management business in all our history. We have -- we've had BRL18.7 billion of net new money in the quarter. BRL26 billion of net new money in the 9-month period of 2019 and BRL47 billion on the last 12 months. BRL47 billion net new money represents roughly 19% of the current level of AuM which is a remarkable performance in terms of asset gathering.

Asset Management is naturally benefiting as well from the current environment. This reflects not only on net new money, but also on the performance of the funds where our -- especially, our Brazil and LatAm fixed income and equity funds have been delivering good performance even though performance fees are not being captured in the third quarter in terms of the P&L because of an accounting phenomenon, they are captured towards the end of the accrual period for the performance fee contracts which are basically due on the second and fourth quarter, so hence the seasonality on our revenues in Asset Management. But also alternative funds have grown in the quarter and in the year and mainly money coming from real estate launches and benefiting from the positive scenario for interest rates in Brazil. And also, we had very positive environment for our LatAm franchise. And we continue to see this positive trend going forward, continue to have the expectation of growing AUM from gains in market share and from raising new clients and more money from the clients, we already have.

Turning to page 13. Here, we have the Wealth Management performance pretty much in line as well with the Asset Management performance. Starting with the graph on the right, we have reached BRL158.3 billion of wealth under management. We have raised BRL8.6 billion net new money in the quarter, close to BRL20 billion in the year in the 9-month period, and close to BRL25 billion in the last 12 months. This is same phenomenon that we see in Asset Management, our franchise being very well positioned to capture that growth in the current economic scenario. There are also growth initiatives outside Brazil. We have opened -- we have increased our Miami presence and we are in course for opening our new presence in Europe in Lisbon.

Also, another driver for growth is the benefit of technology investments that we have been doing, which as we develop the digital platform for our retail Wealth Management clients. This also brings more efficiency and quality to the service offering of Wealth Management, and typically as it happens in our platform, it's a positive phenomenon because of the synergies we obtain with the investments that we do. And as well, the BTG Pactual Digital business which continues to grow and to help with the net new money gathering. But I think moreover continues to be awarded with quality recognition. In the quarter, our business has been awarded with the RA1000 stamp, which is a stamp issued by ReclameAQUI, a platform -- consumer service ratio platform in Brazil, one of the most renowned.

So as we grow, as we offer more products, as we diversify our service offering through the digital channels, we continue to increase quality and that's the game we play. That's where we want to be. We want to be able to differentiate ourselves by the quality of the products, the performance, which goes hand in hand with our 30-year history in Asset Management in the country and also delivering on what we promise. So that gives us a lot of confidence on the trajectory for Wealth Management and for the Digital business going forward.

Turning to page 14. This is Principal Investments where we had good performance coming from our two Merchant Banking portfolios in portfolio investments, Eneva and PetroAfrica, which delivered good results. We had slightly negative results from real estate. Even though we are gathering client assets, the capital that is deployed on our balance sheet in real estate, which is now small, has a element of cost of funding, which is reflected here. And we also had slightly negative revenues for our global market capital allocation in the quarter.

Turning to section two, we're going to talk about expenses and this is another important driver to explain the performance of the year and of the quarter. I would like to highlight on the line cost-to-income ratio going, which is the ninth -- eighth line top-down on the left part of the table. You see cost-to-income ratio going down from 47% in the third quarter of 2018, so a year ago, to 40% last quarter to 39% this quarter.

This is a trajectory and the level that is explained by the benefits that we capture for the whole of the platform for the bank-wide business platform from technology investments we are doing, primarily to develop the digital business. So as we automate, as we promote more integration in the processes, as we offer the ability to -- for our clients to self-serve themselves through our platform without the need for human intervention in the transactions. This creates this efficiency that goes around for other businesses and allows us to operate with higher and higher efficiency as we go on the process.

We have now completed the base case development for our digital investment platform and are in full speed ahead on the development of the consumer banking platform. So, towards the end of the year and beginning of 2020, we will be offering another layer of flexibility services and complementary offering of functionality to our digital retail clients and to our Wealth Management clients.

Turning to Section 3. We're going to discuss now balance sheet which is -- there are some important highlights starting on the quarter. So starting on page 18, here we have the typical picture of our balance sheet and a few comments here. First, starting from right bottom of the page, you see equity and perpetual went from BRL23.9 billion to BRL21.2 billion. The reduction is because we called our perpetual bonds, the additional Tier 1 capital instruments were called in the middle of September.

These were our most expensive liabilities and we decided to call in the quarter exactly to increase the funding profile, to improve the funding profile of the Bank, and that was replaced with senior long-term funding which is cheaper and has been accessed in local markets. So in the end of the day, our funding base has not decreased, it has maintained itself stable, even grew a little bit on the margin. But the cost of funding has been significantly reduced as we took the opportunity to call back the Tier 1 bonds.

And Roberto explained and I'll show in details, also, our Core Equity Tier 1 increased in the quarter and so we have maintained the level of capitalization and liquidity where we want. A second point is that we redeemed some overnight funding during the quarter. Overnight funding is not contributive to funding the business. We don't count on overnight funding. So it doesn't impact our short-term liquidity ratios and it deleveraged our balance sheet marginally.

And the third point to highlight here is our coverage ratio of unsecured funding to credit portfolio, which is still at 200% -- at 199%. So for every BRL2 of unsecured funding, we have BRL1 deployed in the credit portfolio, which gives us a lot of room still to grow credit portfolio as we see the opportunities coming towards the end of the year and 2020.

We are running the balance sheet at 8.1 times assets to equity, which is still conservative and comfortable level. We use to run the Bank comfortably around 11 times. And so at 8.1 times assets to equity ratio, we can still also grow the balance sheet to capture the opportunities that we see going forward.

On page 19 is a picture of the broader credit portfolio, which is essentially the Corporate Lending portfolio plus Wealth Management client credit operation and other types of credit and the growth is pretty much in line with the growth in the Corporate Lending side. So nothing to highlight here.

Moving to page 20. Here, we see in more detail what I already described about the unsecured funding base. First, looking at the column of the right, which is the current picture of our unsecured funding, you see the funding base well diversified through -- not only through sources, but also I shall add through tenors. We have, as I said, redeemed the perpetual, which is the first line on the top. So from 3.5, it goes to 0.4, it doesn't go to zero because we do have some local elapse -- perpetual elapse that count as additional Tier 1. But the main instrument, which was the international bond that we issued in 2013, has been redeemed.

On the other hand, we have increased the level of securities issued which are essentially elapsed in local markets, so senior long-term funding replacing the subordinated long-term fundings -- perpetual subordinated long-term funding and contributing to the reduction of our cost -- of our funding cost overall. Also, as I mentioned, the reduction in time deposits basically on overnight investments, but being also offset by the increase on securities issued which led our funding base to be stable and growing marginally in the quarter at what we believe very sound movement because it reduced our overall cost of funding.

Finally, moving to page 21. Final highlights here. So our capital ratio has been maintained at 15.1% in the quarter compared to the same level on the second quarter. However, you see here the perpetual contribution, the AT1 -- additional Tier 1 contribution has been reduced and in exchange we have increased significantly our core equity from 9.3% to 11.8% and we did that because during the quarter, even though we still don't have regulatory authority to -- authorization to transfer the shares of EFG to our holding company, we were able to implement a derivative transaction their equity linked note through which we transferred substantially the benefits and risks of the acquisition, which allows us to capture this growth in terms of the core equity of the Bank.

So maintaining 15.1%, but increasing significantly the core element of that capital ratio puts us now and further in even better capitalization position and the tendency as you look on the right part of the page is a trajectory of reduction in the average daily trading VaR which will also help to increase the total capitalization ratio.

So, with that, we close our comments on balance sheet performance and we open to questions. And thank you very much for all joining our call today.

Questions And Answers

Operator

Ladies and gentlemen, the floor is now open for questions from investors and analysts. (Operator Instructions) And our first question today comes from Nicolas Riva from Bank of America. Please go ahead with your question.

Q - Nicolas Riva {BIO 16875766 <GO>}

Yeah. Thanks very much for taking my questions. I have three questions. The first one on capital. I see this big increase quarter-on-quarter, about 250 basis points in the Common Equity Tier 1. Was that then mainly related to the issuance of the CHF600 million in this equity-linked note related to the transfer of the EFG shares to the holding company. And if that's the case, when that transfer of the EFG shares to the holding companies is implemented, then in that case, you're not going to have any relevant impact on the CET1 once that happens because you already took it in this quarter. And so, that's my first question.

Second question on the Corporate Lending business --

A - Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Just before you go to your second question, yes, that is exactly correct. Basically, we've -- through this derivative, we've anticipated the capital impacts of what will happen once the transaction is concluded.

Q - Nicolas Riva {BIO 16875766 <GO>}

Okay. Perfect. Thanks very much, Joao. My second question on the Corporate Lending business. So, you did have very strong growth in this business in the loan book in the Corporate Lending book 15% quarter-on-quarter and more than 50% year-on-year. This really contrasts with a very weak Corporate Lending growth that we have seen throughout Brazil, all banks, really because of the -- in any case, these corporates are going to the bond markets for financing. In your view, what explains these different dynamics between what you are seeing very strong growth in Corporate Lending and the other banks in general in Brazil?

And then my final question on the investigation on the joint venture with Petrobras. Looking at the numbers, you really didn't have any impact on your numbers, I know very strong numbers across your different business lines. Is there any update on this investigation. Anything you can share with us? Thanks.

A - Joao Marcello Dantas Leite {BIO 17617595 <GO>}

So going to your second question on the Corporate Lending, we -- you are correct, for the high-grade market, the local capital markets or the asset management industry and even some distributions individuals has competed with the banks, but we are coming from a financial system that over the last few years, saw the departure of two big players, right? HSBC and Citi. So we've been able to grow quite consistently without having to sacrifice quality or spread, even though we are seeing now increased competition and probably the spreads might decrease a bit going forward.

To combat this, we're also making sure that we're diversifying where we're growing our Corporate Lending portfolio. So we're growing in the traditional high grade segment that we always do. We are also growing not only in Brazil but also in LatAm, more specifically in the Andean countries. So we've been growing our portfolio quite strongly in Chile, Peru and Colombia. So this has also helped growth.

We've been growing special situations portfolio and we've been also been quite successful in growing a new digital initiative with that we've been launched a few quarters ago, which is our SME initiative.So overall, you are correct, but given that we're coming from a much lower base, a more conservative balance sheet than our competitors from the last two years, that's why we have been able to show much stronger growth than they have.

And finally, on the last question, you are right, we have not seen any significant impact on our business. If anything, probably we will be growing stronger, if there was not this noise. Specifically we -- there is nothing to update on that. It's now in the legal proceedings. We are following that and we don't expect any big consequence from these actions as everything is easily explainable as soon as we get the chance to go and explain it.

Q - Nicolas Riva {BIO 16875766 <GO>}

Thanks very much, Joao.

A - Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Thank you.

Operator

(Operator Instructions) We have an additional question from Tito Labarta from Goldman Sachs. Please go ahead with your question.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi. Thank you for the call. Just I guess a follow-up on the Sales & Trading. You continue to deliver pretty strong results there. I think in the last quarter you mentioned, normalized, this could be between maybe BRL600 million and BRL800 million. So you're so probably at the higher end of that, but is there anything changed, just you mentioned increased client activity, do you think this BRL800 million could become a new recurring level? I just wanted to get your thoughts in terms of the volatility that we can expect on Sales & Trading going forward. Thank you.

A - Joao Marcello Dantas Leite {BIO 17617595 <GO>}

No. I think it's still too early to say that. Clearly, it gives us much more confidence that the BRL600 million range that you mentioned is becoming more and more solid, less and less dependent on market positioning and more linked to client activity. But I think it's still too early to say that as we have a very benign trading environment over the last two quarters.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay. That's helpful. And maybe just one follow-up i terms of Asset and Wealth Management. You mentioned, so you think maybe or just in general, maybe growth would have been stronger without the recent investigations. So, I mean do you think volume growth there as sort of those investigations get more and more behind us can continue to increase and maybe pick up from the levels that we're seeing, which are already pretty strong?

A - Joao Marcello Dantas Leite {BIO 17617595 <GO>}

As you said, the levels are pretty strong. We work every day to achieve exactly which you're saying, but I don't want to give any guidance on that. We work for that. But as you said, the growth is quite strong, where we are right now.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay. Fair enough. But I guess, maybe another way to ask you just, you know, are you see any major negative impacts that could impact that growth going forward, even with the investigation?

A - Joao Marcello Dantas Leite {BIO 17617595 <GO>}

No.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay. That's helpful. Thanks.

A - Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Thank you, Tito.

Operator

(Operator Instructions) Ladies and gentlemen, I'm showing no additional questions. We will conclude today's question-and-answer session as well as to -- I'd like to turn the conference back over to Mr. Sallouti for any closing remarks.

A - Roberto Balls Sallouti {BIO 4150617 <GO>}

Thank you very much for joining our third quarter earnings call. We hope to see you back in February where we can talk about the full 2020 -- 2019 results. Thank you very much. Have a great day.

Operator

Ladies and gentlemen, that will conclude today's presentation. You may now disconnect your lines. Have a nice day.