

Q2 2019 Earnings Call

Company Participants

- Joao Marcello Dantas Leite, Executive Officer, Chief Financial Officer and IRO
- Roberto Balls Sallouti, Chief Executive Officer & Director

Other Participants

- Nicolas Riva, Analyst
- Tito Labarta, Analyst

Presentation

Operator

Good morning, and welcome to the Second Quarter of 2019 Results Conference Call of Banco BTG Pactual. With us here today, we have Roberto Sallouti, Joao Dantas, and 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 their website, www.btgpactual.com/ir and the platform. There will be a replay facility for this call from August 13th through August 19th.

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 such as, are based exclusively on the expectation 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, and 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 over 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 morning, everyone. Starting with Page 3, we would like to mention some of the highlights of the quarter, a quarter which we are very, very satisfied with the results. So starting with the highlights, first thing to mention is that we

successfully concluded the follow-on offering of 55 million units, which at the time was roughly BRL2.5 billion. With that, we were able to increase the free float, increase the liquidity of our listed unit, BPAC11, and adhere to the Level 2 of governance of the B3.

In the second quarter, revenues were up 47% quarter-over-quarter with a strong performance by all of our operational -- by all of our franchise businesses. So once again, here is what makes us very satisfied, is that the strong performance was from all of our different units, specifically, in Asset Management and Wealth Management. Our AUM has been growing at over 30% year-over-year. With the use of -- with the leverage that we're gaining on our platform, the operational leverage which we are exploring, our cost-income decreased to 40%, and this -- as we continue growing, we expect this level to continue, especially as we continue growing the businesses that we have. And finally, we consolidated our digital retail unit, which we put under the leadership of Amos Genish and we are -- we continue to be very excited with the growth opportunities that this unit brings to us.

Turning to Page 4 and speaking specifically about the results of the second quarter, we had revenues of BRL2.18 billion and an adjusted net income of BRL1.03 billion. This gives us an annualized return on equity of 20.6% for the quarter. And if we exclude the capital allocated to EFG and Banco Pan and only consider the capital allocated to BTG Pactual, the return on equity was 26.2%. Then, this gives us a net income per unit of BRL1.18.

As mentioned previously, our cost-to-income ratio for the quarter was 40% and our comp ratio was stable at 23%, and we closed the quarter with total assets of roughly BRL174 billion, Basel ratio of 15.1% and shareholders' equity of BRL20.4 billion. We also -- after the end of the quarter, we also declared interest on capital or JCP, which will now be paid at August 15th.

Turning to Page 5, when you talk about the results for the first half of the year, we had total revenues of BRL3.66 billion and net income of BRL1.75 billion. This gives us a return on equity for the period of 17.8%, and on the core business of BTG Pactual, an ROE of 22.5%. Cost-income for the semester was 42% and comp ratio stable at 23%.

Turning to Page 6, you can see the revenue breakdown by business unit and what makes us very satisfied is the equilibrium that we have between the various types of businesses in our bank. So for the semester roughly, one-third of our revenues came from our business units that do not use capital, so Asset Management, Wealth Management and Investment Banking; one-third of revenues came from sales and trading, and one-third of revenues came from credit and the other business lines. So we really like this diversification and we expect this trend to continue over the next few quarters and years as we continue to grow our client franchise businesses.

Turning to Page 7, you have a bit more detail of what I mentioned previously, of the return on equity, of our core capital allocated to BTG Pactual, 26.2% in the quarter, 22.5% in the semester. Of the capital allocated to Banco Pan, 12.5% for the quarter, 11.2% for the semester. This is a bit higher than what Banco Pan shows as ROE. They showed for the semester 11.2%, and this is because Banco Pan is booked in our balance sheet at 90% of

book value. And finally, EFG, flattish for the quarter and 2.2% ROE for the semester, and this reflects the results of the first -- the second half of 2018 EFG.

With that, I pass the floor to Joao Dantas, who'll talk about each of our business units performance.

Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Thank you. Thank you, and thanks everyone that join our call. So we're going now to Section 1 to discuss the performance of our business units. Just before we turn to Page 2, Investment Bank, just an overarching comment around our performance in the quarter. I think it's not common to see all our areas delivering exceptional performance. It's fair to say we've been performing -- we're hitting on all cylinders, if you will, and this is a nice quarter to observe how the bank can deliver stronger results in moments like that. We have had just benign environment and a regain of confidence from investors and clients and this has allowed us to really deliver at full speed.

So turning to Page 9, we start with Investment Banking. We reached BRL186 million of revenues in the quarter, slightly higher than the first quarter. This is one of our highest Investment Banking revenues ever, including the second quarter of 2018, but it's also one of our highest Investment Banking volume of activity ever. And that's true for M&A for ECM, DCM and for project finance.

So just to give an example, for DCM, while in the first quarter, we had seven deals, we closed 24 deals in the second quarter; ECM, from four to nine deals; in M&A, from four to 14 deals. We haven't seen this level of activity for a long time and we are very optimistic that this level will maintain. And we have reached this high level of revenues without any particular jumbo deal in the quarter. So it's been really a diversification and the consequence of us reaching a very strong market share in the industry, not only in Brazil, but also in Latin America.

In M&A, we are the number one in number of transactions in Brazil and Latin America. In ECM, we are the number one of number of transactions in Brazil and Latin America, and also the number one in volume in Latin America. So our market share was particularly strong on the private sector. We haven't participated much in deals that involved public -- government-controlled companies selling assets or government-controlled assets being sold. So we're very happy with the performance and the results that we are delivering.

Turning to Page 10, I'm starting from the graph on the right side. We see that the portfolio of Corporate Lending went from BRL26.1 billion to BRL34.2 billion in one year. It's a 31% growth. We have a portfolio of Corporate Lending that is equivalent to 1.7 times our book value, which means we still have space to grow our corporate exposure even further. We have provisions of 4.7% of our total portfolio, which makes us very comfortable, and with the portfolio growth of 31%, it's important to note that while we grow, we have been able to maintain the credit book quality. We're basically deploying credit to the same segment, to the same quality, and to the same -- with the same level of collateralization that we've always done. So we've maintained the credit book quality throughout.

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Underlying revenues are also growing, growing slightly less than the total portfolio, which means that we continue to have the ability to deliver stronger results, while the running costs are also compressing in terms of total revenues, which allows the Corporate Lending business to maintain its net contribution to our ROE.

We did have some transactions in special situations that have materialized and we capture revenues out of that. But moreover, special situations has been performing very well and continue to be a source of interesting opportunities for capital allocation for us.

And a final comment, the SME lending book, it starts to kick in. That business is being conducted under the leadership of the digital retail unit, and it's now starting to show strong opportunities and possibilities for us to capture corporate lending growth in the SME space.

Turning to Page 11, here, we have Sales & Trading, and in the quarter, we have reached BRL886 million of revenues in Sales & Trading, one of our best quarters since our IPO. And we -- of course, we increased market risk and balance sheet usage for Sales & Trading. As we saw benign markets allowing us this significant increase in volumes and a relevant progress in the quarter was made in terms of the interest rates convergence and valuations in Brazil.

I think it's important to say that the pension reform approval is a monumental milestone for the country and we remain confident that that approval will be achieved. And following that approval, we believe that the economic team backed by other ministries will be capable to comprehend further what hinders our growth potential in the country and it will continue to propose a series of measures that address, in a proper manner, the limitations we have to realize our growth potential. This means that we expect a continuation of the benign market environment, a continuation of slowly and gradual increase in the investors' and entrepreneurs' confidence levels. Gradually, we'll capture a bigger share and growth in terms of the presence of international investors, and in that scenario, we should continue to perform well in Sales & Trading.

Turning to Page 12, that's the Asset Management business. Looking at the graph on the right, we went from BRL170.4 billion AUM to BRL226.4 billion AUM. This is a 33% growth year-on-year with strong net new money and almost all of the quarters except the first quarter of this year, which I will comment specifically. Revenues went from BRL167 million in the first quarter to BRL227 million in the second quarter.

A few comments here. The first, the performance of our LatAm fixed income and equity funds have been solid. Especially the equities and credit categories, we've been performing certainly in the top decile against our competitors. Second, management transition has been completed. Now we have Edoardo Guardia, fully active CEO; Will Landers fully on Board. So for a business like ours, which is institutional asset management, it's natural that in a quarter of management changes, we have slower net new money pace, but now the team has met all of our main clients, have been covering the ground, and now we're functioning as we expected.

As we grow our AUM, we see our ROAEs by fund category stable, which means that by fund category, so meaning equities, credit, multi-strategies, etcetera. ROAEs have been stable year-on-year. The change in the mix of AUM is what dictates the change in the ROAE for the overall business, but this maintenance of ROAEs is quite important. As we grow, we are able to capture more margin and more bottom line contribution from Asset Management business. And finally and most important, the firm is very happy with the performance of our Asset Management units and continues to be confident on the back ahead for that business.

Moving to Page 13. This is Wealth Management business, where we went from BRL107.3 billion of wealth under management to BRL141.9 billion wealth under management, also here 32% growth year-on-year. In the revenue growth reflect that, we went from BRL131 million in the first quarter BRL155 million in the second quarter. LatAm teams have all been performing and delivery throughout our offices in Chile, Colombia, Peru, Mexico and Brazil. We also have new growth initiatives that are performing well. Our Miami office has been growing substantially. We're now at the verge of launching our Lisbon presence. We have requested regulatory approval some time ago and we believe that this approval is about to be granted. So, everything going very well in the Wealth Management business. And inside our Wealth Management business, we already see some growth from the digital investments platform that has been running fully fledged for almost a year now and in which we believe there is more growth to come.

Turning to Page 14. Finally, from the business comments on principal investments. Basically, we had captured very positive performance from Merchant Banking, where basically the investment (inaudible) has delivered through mark to markets. We also have a slight negative contribution from global markets, which is not in line with the performance of the funds, because here, we have some cost of funding being applied against the portfolio. But if you look at the performance of our global hedge funds, they have delivered adequate performance in the first half, and some negative contribution from real estate just because of the funding allocation to that business.

With that, we move to Section 2 to talk about expenses and efficiency ratios. So, in the quarter, our cost-income ratio is at 40% and our compensation ratio was a 23%. If you look at the three columns for the quarter, you see that in the line cost income ratio, the KPI has been decreasing from 47% in the second quarter of 2018 to 43% first quarter this year, 40% second quarter this year. Compensation ratio is stable at 22%, 23%. So as compensation ratio is stable, because it includes both fixed and variable compensation, which includes bonus, which tends to be higher when we make more profit, our cost-income ratio depicts appropriately the benefits from our operational leverage that Roberto has alluded to in the beginning. Our efficiency ratios, our compensation ratio is going down as we capture benefits from our operational leverage. So, as we invest in IT, we need less people to control and process our transactions, we can have more clients with less costs and this is what transpires through the cost-income ratio and is important to understand that movement. Also, in the quarter, as we had higher margin contribution, we also have effective income tax rate higher in the second quarter than in the first quarter.

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But since Brazil runs at a 40% tax rate -- corporate tax rate for banks, we believe 25.2% is still adequate as we make use of JCP to balance the tax rate in our business. And also important to mention here is the coverage ratio. Coverage ratio, which is not included in the page, is a comparison of our fee-based income to our total costs, excluding bonuses. And we've always looked in our business to our coverage ratio because it gives us the measure of how much we can support on costs without using the balance sheet.

And in 2019, in the second quarter, our coverage ratio is 156%, which means that for every real of costs we have BRL1.5 of fee-based income. And back in 2014, the coverage ratio is exactly the same, was 155%. So, it's very nice to see that our business is back to that efficiency level that we have before and we put through -- walk through our operational leverage that we can capture even further benefits from that growth.

So going out to Section 3 and to talk about the balance sheet on Page 18, you see that our total assets have reached BRL173 billion, which is about 7.2 times assets to equity. As you know, we've always have run the bank was around 10 times assets to equity leverage ratio, 7.2 times is a very comfortable measure, which means the balance sheet is still conservative and we still have room to apply more capital and use more balance sheet to capture growth benefits.

Also, in terms of liquidity, our cash is at BRL21.8 billion, which is still more than our equity. In our LCR, which is the liquidity coverage ratio, which is the stress measure off liquidity for 90 days is at 231% comparing to the minimum requirement of 100%. This means, we are ready to deploy more balance sheet, we're very liquid and still have room to grow.

Moving to Page 19, this is the broader credit portfolio, which basically went in line with the 32% growth in Corporate Lending and also in line with the quality of the Corporate Lending portfolio.

Moving to Page 20, another measure of growth is the growth of our unsecured funding base. We went from BRL40.4 billion of unsecured funding to BRL52.2 billion in the current quarter. So a 30% growth year-on-year compared to the second quarter of 2018. And as you go line-by-line, you'll see that we had stable or increase in our stability or increase in each of the funding lines, which makes us confident that our funding -- as our funding grow, we are able to tap adequately in all funding sources, which gives us the ability to continue to grow our funding base to support the business.

Also the funding costs as a percentage of CDI has been reducing, as we have been successfully accessing local funding sources; we have also a benign funding environment in Brazil, we are taking advantage of that quite substantially. So all sources kicking-in and we are also ready for more growth going forward.

And finally, on Page 21, we see Basel ratio and VaR, starting from the VaR as a percentage of average equity. We have reached 0.74% of average VaR as a percentage of average equity. We have used more VaR before. This is not historically the highest level of VaR, but it is indicating that we're deploying capital and using the balance sheet quite substantially, which reflects in the reduction on Basel ratio from 17.6% to 15.1% in the

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quarter, but it's important to bear in mind that we still have one transaction to implement, which is the transference of our stake in -- the majority of our stake in EFG to our holding company, which will boost the capital ratios again, and we expect their transaction to be approved and implemented still this year. So looking at that impact, we would be actually very comfortable in terms of the capital ratios. And the transaction only now depends on regulatory approval since the internally what we needed to do was to complete the follow-on offering, which gave our holding company enough liquidity to settle that transaction quite comfortably.

So, these are our comments for the performance of the business and now, we open the floor to questions. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) The first question today comes from Tito Labarta with Goldman Sachs. Please go ahead.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi, good afternoon. Thank you for the call. And a couple of questions. I guess, first, just trying to understand the sustainability of the results. I mean, particularly I guess in the more volatile lines, which had very good quarters on your Sales & Trading and then, Investment Banking and even Principal Investments to a less extent I guess. But, how should we think about these going forward? Are these sort of a new levels that we should think about or I think is going to be this volatile? I mean, particularly Sales & Trading has more than doubled in the last couple of quarters. I mean, was there anything specific there that we should think about in forecasting these lines?

And then second question in terms of your digital strategy. Just wanted to get a sense if you can give some more color on how you see that is benefiting the business? I mean, we're seeing strong growth in Wealth Management around 30% in net growth increase or maybe you can quantify how we should think about the digital strategy and the benefit to the business? Thank you.

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

Thank you, Tito. So, the first question on the sustainability. Considerably, we see the volatility and the more volatile lines within the regular volatility of the business. As, especially in Sales & Trading, we are -- what we consider within the range, right. We have a median and then it can be higher, it can be lower. We think that median grows every year a little bit. But, as I've said before, I think in Sales & Trading, we already have a leading market share. So our performance there will be pretty much with the market respecting the normal volatility in these businesses.

In investment banking, once again there, I don't think we can gain market share. We are benefiting from the market. So assuming that we're now in Brazil at a new level of interest

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rates, which has picked up capital markets activities and I think it's quite feasible than investment banking, the market is doing a permanent change and this means that our business should be naturally still have some volatility but at higher levels than in the past. And to your second question, on digital, I would say that it's clearly at our budget. So, just as expected. As you said, you can see this growth in Wealth Management, we have expect this level of growth in Wealth Management overall to continue. I really do would not like to say if I think it can accelerate or not. Naturally, we would be happy if it does. But we are quite satisfied with the 30% to 35% increase year-over-year.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay, great. It's very helpful. Maybe just one follow-up on the Sales & Trading and I understand it is volatile, but if we -- just trying to get a sense, I mean, if you look a year ago, you're almost four times higher, right. So it is a volatility between this BRL400 million and BRL800 million or do we still think about the BRL200 million levels that we saw last year. Just wanted to get a sense of what's the right range of volatility? I guess if you can give --

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

I would say that BRL200 million was a very specific moment where we were very conservative with our balance sheet given the level of uncertainty of both the local scenario with elections, and the international scenario, which was quite volatile at the time. So, definitely, I think that is a cyclical low, as we were very, very conservative. So, I would probably say it's more in the higher bar [ph] than that.

Q - Tito Labarta {BIO 20837559 <GO>}

Okay, perfect. That's very helpful. Thank you.

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

Thank you.

Operator

The next question today comes from Nicolas Riva with Bank of America. Please go ahead.

Q - Nicolas Riva {BIO 20589225 <GO>}

Yeah. Thanks for the opportunity to ask questions. My first question is regarding the role of Andre Esteves, I believe that you were trying to get Andre Esteves back to a control group of the company. If you can give us an update on that? Where that stands and also the role that you envision for him at the bank if he is going to have a most senior management role?

And then the second question on capital. So the CET1 decreased 100 basis points quarter-on-quarter. Was that driven by the payment of dividends because your net profits were quite strong this quarter? And also regarding the spin-off of the EFG shares from the bank

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to the holding company, you said that's expected before the end of the year. You can remind us the impact on capital ratios from the transaction? Thanks.

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

Sure. So on Andre Esteves, as you said, we are in the process with the regulators of approving his returned to the control group. We expect that to be concluded hopefully soon. The issue there is that we have to deal with 33 regulators over the world. So it is a cumbersome process, which takes some time. And it's the same thing with the sale of the EFG to the holding company. We are in -- within the regulatory process and we expect a 300 bps increase in core equity Tier 1 once the transaction is concluded. And on your question regarding the decrease in core equity Tier 1, it was basically because of the increase in the risk weighted assets, especially more related to market risk and this can be seen in the increase in the VaR, and also in the increase in the Sales & Trading revenues.

Q - Nicolas Riva {BIO 20589225 <GO>}

Okay, thanks very much. And maybe a follow-up regarding the role of Andre Esteves, is he expected to have a role in senior management as well or just as a very relevant shareholders of the bank?

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

Yes. His role today is that of senior partner which -- and as you know, we are on partnership. So it works very well because we are very accustomed to discussing everything to seeking consensus when decisions are made. I am the CEO, but that does not mean that it's a dictatorship, right. It's still a partnership where we use the input, the knowledge of all of our partners to reach the best decisions. So in the short-term, what we foresee is that this role will continue, he has been working very well. Actually think this arrangement that we have and how we've been functioning over the last three years is reaping the benefits are here, right, the results are very clear to everybody. So since early we see no reason to change for this -- to change this, but we just thought it was the right thing to do for him to get back to the control group.

Q - Nicolas Riva {BIO 20589225 <GO>}

Okay, thanks very much.

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

You're welcome.

Operator

(Operator Instructions) Thank you. That brings us to the end of the question-and-answer session. I will now return the floor to Mr. Roberto Sallouti for his closing remarks.

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

Once again, thank you all for joining our quarterly call on results. We look forward to seeing you next quarter again. Have a great day.

Operator

Thank you. This concludes today's presentation. You may now disconnect your line at this time and have a nice day.

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