Q4 2017 Earnings Call

Company Participants

- João Marcello Dantas Leite, Chief Financial Officer, Executive Officer & Investor Relations Officer
- Roberto Balls Sallouti, Chief Executive Officer & Director

Other Participants

- Carlos G. Macedo, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, and welcome to the Fourth Quarter of 2017 Results Conference Call of Banco BTG Pactual. With us here today, we have Roberto Sallouti, João Dantas and Pedro da Rocha Lima.

We would like to inform you that today's event is being recorded and all participants will be in a listen-only mode during the bank's presentation. After Banco BTG's Pactual remarks, there will be a question-and-answer session for investors and analysts when further instructions will be given.

Today, we have a simultaneous webcast that may be accessed through the website, www.btgpactual.com/ir and mziq platform. There will be a replay for this call from February 28 through March 7.

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'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 or good morning to those of you on the line. Just before we start with the presentation, I would just like to make a qualitative comment about the results of the first quarter - or the fourth quarter. We are very satisfied with the results because we believe they start to show the underlying trend of our business platform starting to use the operational leverage that we have within the platform.

What we see - we saw this past quarter with the increase in asset management, wealth management and credit businesses is what we expect will continue to happen over the next few quarters. And all of this with a very - or basically minimal cost increments, As we have always said that in the last couple years, we've had excess capacity in both capital and human capital or human capacity. And actually what we saw with the increase of the balance sheet and the increase in credit portfolio, increase in AUM and in assets under wealth management in last quarter is the trend where we are seeing all of these business signs increase, and a more - thus a more efficient capital allocation and actually capacity allocation on the part of the bank.

So turning to page 3, we finalized the fourth quarter of 2017 with total revenues of BRL 1.4 billion and an adjusted net income of BRL 745 million which gives us an ROE of 16% and a net income per unit of BRL 0.84 per unit in the quarter. We had in the quarter cost ratios and - normalized cost ratios in line with our historical average. So, a normalized cost ratio of 45% and the comp ratio of 27%. We will talk a bit in the next page about the cost to income for the full year, but it shows you that we're running at the - even though we have operational leverage in the platform, we are running within the historical average of our efficiency there.

And finally, as I mentioned previously, our assets grew in the quarter to BRL 126 billion, increasing the leverage ratio of the balance sheet to 6.8 times. And we finalized with a capital ratio of 18%, slightly above the third quarter. As we mentioned in the third quarter call, we had a bit more market risk than the norm by the end of third quarter. But as we went back to the normal VaR, with this, our Basel ratio increased slightly in the third quarter. We also announced in the third quarter a JCP of BRL 609 million and had during the quarter an average VaR of BRL 120 million or 65 bps over shareholder equity.

Turning to page 4, when you look at the full year results, we finalized the year was with a 16.3 ROE with a very diversified performance from all of our business units. We finalized with revenues of BRL 5.5 billion and adjusted net income of BRL 2.9 billion and this gave us a net income per unit of BRL 3.32. As I mentioned previously, we had a cost to income ratio within our historical average. We finalized the normalized cost income ratio at 38%. We did have some one-offs especially related to legal expenses, which increased this to 48%, but as we expect these to stop happening, we might have a small fall-through still in the next quarter or two, but we expect to return to this normalized ratio very soon.

And finally, for the full year, we had a net margin of 53%. We finalized the year with net income of BRL 18.5 billion, growing our equity 4% after taking into account the JCP distributions that we had during the year. And this gave us - gives us a book value of BRL 20.84 per unit of our shares.

Finally, turning into page 5, you can see the revenue breakdown within the different business lines. The percentage of sales and trading is a bit - a bit above what we consider the historical norm as we expect over the next few quarters, the revenue lines, both the absolute numbers and the percentage of total revenues to increase in Corporate Lending, Asset Management, and Wealth Management. You've kind of noticed this throughout the quarters of the different - of 2017, but we expect this underlying trend to continue in 2018.

With that, I pass the word to João Dantas who will give a bit more detail of each of the business lines.

João Marcello Dantas Leite

Thank you, Roberto. Thank you all for participating in the call. This is our 25th earnings release; it's our sixth year as a listed company.

Turning to page 7. Investment Banking industry is in a positive market trend throughout LatAm. We have reached a BRL 144 million of revenues. The main contributors here, the number one contributor is M&A where we have the best quarter in the year and see a healthy pipeline of deals. ECM also had the best quarter in the year and is also a strong contributor and ECM also performed well. Interesting to note that our LatAm franchise - LatAm ex-Brazil franchise is growing as a participation in total revenues. But moreover, I would like to highlight the market position of BTG Pactual. We ended 2017 as number one in M&A transaction volumes in Brazil, and number two in Latin America, and also as number one in ECM, number of transactions in Latin America.

Turning to page 8, in Corporate Lending, you see that we are presenting our fifth consecutive quarter of portfolio growth. Portfolio went from BRL 19.3 billion in the end of 2016 to BRL 21.8 billion in the end of 2017. This growth is allowed by a stronger origination. We originated last year close to BRL 6 billion of credit, and we reached a BRL 162 million of revenues. The growth of the portfolio comes with continuing average spreads. They continue to be attractive for the Corporate Lending business in Brazil and also with an unchanged quality of the portfolio. The portfolio quality remains unchanged as we have grown throughout the quarters of last year. Also, the levels of provisions have increased marginally on the quarter and have reached about 5% of level of provision which puts us in a very comfortable position in terms of the quality of the portfolio and the level of reserves that we have built.

Also interesting to note that we see a strong pipeline of NPL opportunities ahead of us. There is significant revenue contribution from the business throughout the year, some revenue contribution of that business in the fourth quarter and we are optimistic about the opportunities for NPL going forward.

Turning to page 9, Sales & Trading representing solid returns. We have reached BRL 691 million of revenues. The main contributors are the equities and the energy desks, which had strong performance in the quarter. But also, we had good performance from our other desks. The vol utilization has marginally decreased during the quarter to 0.65% of our average equity. And I think furthermore, the results are adequate and – but the business is expected to benefit from the rates decline environment that we've seen. Rates have now stabilized in a level that we see for the upcoming quarters.

We carry no legacy in that business in the sense that the rates decline does not put pressure on our revenues. As you know, the revenues that we post here are already net of the funding cost. And what we see actually is opportunity; because as we see rates decline, we see our counterparties looking for longer maturity and higher yields, looking for more sophisticated solution. There is a need for more complex understanding of needs and providing solutions for clients and this pushes our Sales & Trading into growth.

Also, it's important to note that we observe that despite the recent volatility events, especially coming from the changes in U.S. rates impacting volatility in the prices of emerging market assets, we continue to see strong and resilient floats – flows into emerging market funds and also into the LatAm markets. We see that flows continue to be strong and resilient and we see that also as an opportunity to grow the Sales & Trading business going forward.

Page 10, Asset Management is definitely a growth story. We have reached the BRL 169 million of revenues and we have reached BRL 144.9 billion of assets under management. Year-on-year, it's a 25% growth and the growth is coming – basically, the main contributor for the growth is the top performance of our LatAm and global liquid strategies. Asset growth continues on a very strong pace. We also have significant operational leverage, which ensures that we can grow our top-line without increasing costs.

The ROAs are stable. They are marginally expanding because of the growth in assets under management but also because clients are shifting their allocations from the more short-term type of mandates into longer maturities and higher yields where we charge typically higher fees as well.

Management fees have grown in every quarter throughout 2017. Here in the graphic what you see in the bar is the combination of management and performance fees, but the underlying trend is that management fees are growing consistently quarter-on-quarter. And in the fourth quarter, we also had significant contribution from performance fees, of course due to the fact that funds are presenting very good performance, top-quartile or top-decile performance in our asset classes that we managed throughout LatAm.

Turning to page 11, Wealth Management is another growth story. We have reached BRL 98 million of revenues and BRL 86.9 billion of Wealth under Management, which is a year-on-year growth of 18% on our Wealth under Management. We have a very positive environment for our Wealth Management business across LatAm. Clients are actively looking for diversification and maturity and assets are growing as a consequence of that. The environment offers – creates demand for different mandates. We have to think through the client needs. Clients are changing their portfolio allocation all the time. And this is a challenge to the competition and we believe, our Wealth Management platform is very well positioned to benefit from that, since we are able to offer creative solutions with agility, understand client needs and we have been doing that very consistently throughout the years.

And also the Wealth Management platform I should say is benefiting significantly from the investments we are doing in our digital platform, since the same investments that we do for Digital also provide technology enhancements that improve the client and user experience in our platform.

And finally, just to comment on this small negative Net New Money of BRL 200 million in the quarter, that's concentrated in custody mandates. We continue to see here a shift into longer maturity and higher yields and the BRL 200 million that we lost here, net, actually represents a growth in ROA. The money that left us, it's on very low ROA mandates.

Turning to page 12. Principal Investments, I think the main message here is that our exposure continues to reduce to Principal Investments. The only thing to highlight is that we had a negative performance in global markets, where the losses were concentrated in liquid strategies in global developed markets, especially equities, but this is not a trend, this is a one-off event for the quarter.

Investment Banking and Real Estate, there are no highlights. Basically the negative number is just because we charged the cost of funding into depositions and this represents just the cost of the capital usage of these areas.

On Section 2, turning to page 14, we have comments on expenses and main ratios. As you see, cost to income ratio for the quarter was 54%, but normalized for the one-off costs, our cost to income ratio was 45% for the quarter. The one-off costs are the legal expenses and we also adjust for the goodwill amortization to reach the 45% cost to income ratio, which for the quarter is in line with our historic average or slightly above, if you will.

But for the year of 2017, even though we had 48% cost to income ratio for the year, adjusted for one-off costs, we actually had 38% cost to income ratio, and the 38% is actually below our historical average and shows that we are running the platform efficiently, even though as we mentioned before, we still have significant operational leverage to continue to grow.

Salaries and benefits are pretty much under tight control. We have grown a number of employees slightly in the last couple of quarters, but the kind of employees that we are hiring is the junior, very talented people who we hire a very young age and train and develop here. So the salaries are on the low edge of the spectrum. So, no pressures over salaries and benefits and this should be continuing as a trend going forward. Administrative and other expenses, also in line with historical averages after adjusting for one-off legal expenses. And you should consider also that we are running our – all our investments in the digital platform enhancements are being run entirely through P&L. So we're not – we're not capitalizing the costs of the platform development. We're running them through expenses and even though we're doing that and we're doing significant investments as you know in the digital platform, costs continue to be under control.

And finally, income tax rate in the quarter has benefited from the payment of taxes towards dividends, the JCP. And that's typically what you see happening for us in the - in the last quarter of the year and in the second quarter of the year, when we typically declare dividends and tax deductible dividends, JCP.

Moving on to Section 3, balance sheet on page 16, you see that our assets have grown to BRL 126.6 billion which is an 11% growth quarter-on-quarter. Not entirely a structural growth in assets. The largest part of the growth comes from asset financed through REPOs and trading portfolio of assets, which is liquid securities and securities financed through REPO. But a part of this is structural; a part of this asset growth already indicates that we are taking advantage of opportunities to deploy more capital and we should continue to - continue to see that trend throughout 2018.

Our leverage ratio is still at very conservative levels. We're running with 6.8 times assets to equity. And as you know, we use - we are used to running the business with 10 times to 12 times leverage ratios, so we still have room to comfortably grow our credit portfolio and have some structural growth in the asset base in the upcoming quarters. LCR, which is the liquidity - regulatory liquidity measure is at a very comfortable 145% ratio, which shows that liquidity management also remains in very prudent mode.

Our unsecured funding base, I will comment on that further down on the presentation has grown in the quarter; 3% quarter-on-quarter and realized a 12% growth which also makes us confident that we can continue to grow our asset utilization. And the coverage ratio, which is the coverage of unsecured funding to on balance sheet credit remains at very high 217% ratio. All those fundamentals allows us to continue to be confident that we will grow credit portfolio as we see opportunities and other - deploy more assets in our core activities as we see opportunities going forward.

On page 17, we see a picture of the broader credit portfolio, which is the same picture that we see for our Corporate Lending portfolio business. We have grown 17% year-on-year, the credit portfolio. It includes - besides Corporate Lending, includes our Wealth Management and other credit transactions. And the trend here is going to be very similar to the trends in Corporate Lending; continue to grow in a moderate pace, taking advantage of opportunities and keeping the high quality of the assets in the portfolio.

On page 18, we have the unsecured funding base, and here, a couple of highlights. As you know, we have bought back a portion of our perpetual bonds, which you see in the top-line. We also have issued successfully a BRL 500 million five year senior unsecured bond in the beginning of December last year, which has contributed to the expansion of our securities issued. The transaction was very successful, more lead (00:21:57) times oversubscribed and it was our comeback to capital markets since 2014, which made us very happy with the outcome. But also important to note, we have grown our time deposits base. The time deposits base is basically bilateral funding transactions with our clients; our own clients and local counterparties, and here we see normal levels of activity. Average funding costs remained stable in the quarter.

And finally on page 19, you see Basel index ended the quarter with 18%. As we explained it before, the 17.3% ratio on the third quarter indicated that we were using slightly more VaR and this - as this normalizes, you see VaR returning to 0.65% of average equity. We also see Basel ratio stabilizing in 18%, which is around what we expect to be running the bank throughout 2018.

With that, we end our comments, and happy to take your questions. Thank you very much.

Q&A

Operator

The floor is now open for questions from investors and analysts. The first question today comes from Carlos Macedo with Goldman Sachs. Please go ahead.

Q - Carlos G. Macedo {BIO 15158925 <GO>}

Thank you. Good morning, or good afternoon Sallouti, Dantas. Couple of questions, both on your loan book, the credit portfolio. You mentioned that you are expanding at a moderate pace, taking into consideration the asset quality, credit worthiness and all that. Your competitors, at least the large retail banks, in the guidance they have given for - their corporate book has been not particularly strong, 5% growth at the best if not less. Even though the BNDES is kind of out of the picture at this point, they don't really see too many opportunities.

What do you mean by moderate growth? What should we expect? Are you going to get to double digits? In the past, you used to have the objective of having the credit portfolio be three times the size of the equity that you moved away from that. Is that something that you think about going back to? Is there a target there?

Second question, a little bit more technical. You mentioned that one of the reasons that the revenues from the credit portfolio were down sequentially was that you had higher provision costs. When we look at your financial statements, you actually had a reversal in your provisions line. Could you help me just make sense of those two factors and what led to the reversal and what led to the lower revenues in the credit operations? Thanks.

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

Thank you, Macedo. So on your first question, yes, we are seeing - naturally we are following the comments from some of the commercial banks and in our view, it's quite simple. Let's assume their portfolio - their corporate portfolio is anywhere between BRL 200 billion and BRL 300 billion. For you to grow above 5% a portfolio of that size, it is a bit more challenging given the current environment and the national corporate credit in the country and the region. However, our corporate lending portfolio was BRL 21 billion.

So for us to have a growth of anywhere between BRL 5 billion and BRL 10 billion throughout the year is very doable, especially given that the banking concentration also increased with the two foreign banks who left the country in the last two years. So, we see that there is – we have a very attractive pipeline. We are deploying just as we speak and seeking this growth.

So the growth you can expect from us is anywhere between, I don't know BRL 4 billion to BRL 10 billion throughout the year, which is in the double-digits. And the reason we think that is a very different scenario than the commercial banks we're facing (00:26:28) is just a matter of the sheer size of the portfolio.

With regards to your question on the reversal, I'll let Dantas give you – you are right; we actually did receive payment of a credit that we had provisioned. And the – and then that way, since we received payment of something about – I believe it was a 100% provision. That was a big reversal. So with the exception of that case, we increased provisions on the other credits.

A - João Marcello Dantas Leite

Yeah, so if you look at the remainder of the portfolio, after receiving that credit which we always expected to receive, was under renegotiation and renegotiation process was going pretty well. But after receiving that and reversing the provision, the remainder – the remainder of the provision had increased through P&L, and that's what we say, we booked more provision for the remainder of the portfolio. We are at a higher level of provision. And again, on the first comment that Roberto mentioned, just to re-emphasize, our book is much more alpha than the others. Our competitors tend to be more beta-driven on the credit expansion. We are more alpha, we can be more selective. We have a smaller book and that allows us to expect higher growth rate – pace for the credit portfolio this year.

Q - Carlos G. Macedo {BIO 15158925 <GO>}

Okay. Great. Thank you. Thank you both.

Operator

Thank you. This 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>}

Thank you very much for joining the call. We look forward to talking to you at the end of the first quarter once again. Thank you very much. Have a good day.

Operator

Thank you. This concludes today's presentation. You may now disconnect your line. And have a great day.