Q1 2016 Earnings Call

Company Participants

- Marcelo Kalim, Chief Executive Officer

Other Participants

- Carlos Macedo, Analyst

Presentation

Operator

Good morning and welcome to the first quarter of 2016 Results Conference Call of BTG Pactual. With us here today, we have Marcelo Kalim, 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 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. There will be a replay facility for this call for a week from May 11th through May 17th.

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 BTG Pactual. These are merely projections and, as such, are based exclusively on the expectations of 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 BTG Pactual's filed disclosure documents and are therefore subject to change without prior notice.

Now, I will turn the floor over to Mr. Marcelo Kalim, who will begin the presentation. Mr. Kalim, please go ahead.

Marcelo Kalim {BIO 16142515 <GO>}

Good afternoon. Good morning, everyone. Thank you for attending this call. We are very pleased to announce our first quarter results for 2016. Before we enter into the announcement itself, I want to say that we are very satisfied with the results that we are showing. Not only because of course our company has been through the very challenging times in the past few months, but also, Latin America and Brazil, in particular has also been through very challenging times.

So being able to show success from performance and also a very solid business, gives us a lot of pleasure and confidence in the future ahead. So results for the first quarter 2006 [ph], total revenue reached BRL3.6 million, which is a record, our highest revenue per quarter ever and net earnings of BRL1.1 billion. This translates into return on equity for the quarter annualized 18.8% and the net income per unit of BRL1.19. Also in this quarter, we announced some cost reductions mainly reducing downsizing personnel and we were able to kept costs under control. However, we will not be able to see the effect of this cost reduction this quarter, because we had the cost related to downsizing this quarter, but not the benefit of lower cost, we will be able to see that as we go on -- on the other products [ph].

Total assets on the balance sheet for this quarter reached BRL234 billion, which is 12% lower than the fourth quarter of last year, and 30% lower than the third quarter of 2015. Our Basel ratio stayed at 15.5%, stable from last quarter. Even though our value-at-risk increased to 1.16% and we're going to see why that happened as we go through the presentation.

Also it's important to mention that our book value per unit reached BRL26.47 and this is an important metric book, because usually we look at the increase in the shareholders equity, which reached BRL23.2 billion, a BRL4 billion increased from where it was in the first quarter of last year. However, our net earnings generation was greater than that, because we are under a stock buyback program. So we paid return or earnings to shareholders to shareholders through the stock buyback program and this is better reflected as looking at the book value per unit. So as we continue to have this program, we believe this is a better way to look how we are really generating earning powers to our shareholders.

Going to page four, we can see how our area's performance and we have total revenue by area here. And the two highlights are sales and trading, very strong performance and wealth management, which were driven higher by the performance of our BSI unit. And we're going to talk now more about the areas as we go forward.

And as a matter of fact we can change now to page six, where we talk about Investment Bank. Investment Bank, we had revenues of BRL62 million, a very slow quarter, I would say, probably the lowest quarter ever in M&A and capital markets activities that we have seen in the lifetime of 15 years. But I think the good message here is that we maintained our leadership position both in M&A or Financial Advisory and equity capital markets, who were number one in the volumes in Brazil and Latin America for these two categories. DCM, we maintained a number two position in transaction volume in Brazil. And this gives us a very good picture, because we believe this year probably is going to be like last year, where headquarters with higher revenues than the other and more likely than others, second and third quarter will be better than the first one, some transactions were already announced recently closed transaction and we believe we can get the revenues of those transactions in the following quarters.

And -- but more important than that is that our leadership position after such difficult times that we have been through put us very -- in a very good position to get extremely good revenues from this area, when markets pick up. And we believe that especially the Brazilian economy is going through a transition phase and we believe the max 12 or 24 months are going to be far better than the previous 12 or 24 months and certainly our position (inaudible) to record significant revenue growth.

Turning to page seven. We have corporate lending. And here, two numbers to highlight, one, of course, the revenue itself BRL206 million, a very good quarter and the two components here, one is, let's say, the normal running rate of our corporate lending portfolio, but also one-off on our NPL portfolio. We have seen in the past four [ph] quarters that from the time to time, we had this quite significant one-offs and this had been (inaudible) again this quarter.

Talking about the size of the corporate lending book, it's quite relevant, reached BRL25.8 billion coming down from 29 in the fourth quarter of last year and 42 from the third quarter of last year. And this is a very significant reduction. And it was implemented of course by two things, one, we already started downsizing the portfolio during the year of 2015 and we have to decrease even more the portfolio in the beginning of this year due to liquidity issues.

This liquidity issue, I don't think, is no longer our problem and that's not what is driven the reduction of the portfolio. However, we believe to have corporate lending portfolio that is more or less one time our equity would be a very prudent measure right now and since our equity is around BRL23 billion, we believe the portfolio should be around that. As a matter of fact, we can expect this portfolio to be between BRL20 billion and BRL25 billion going forward.

And actually this is a very emblematic way on how we do manage risk and I think credit risk is a good proxy for the corporate lending book. We have seen that our portfolio grew to three times our net equity when we thought the economic conditions were right. We tried to decrease that to two times our book value when we saw deteriorating market conditions and right now we are at one times our net equity, which is a very conservative approach. And hopefully, we'll be able to exploit the opportunities going forward, if they appear since we are in a very good position.

Talking about the quality of the remaining portfolio. We are very confident that the marks in our book are very conservative. So we do expect to have strong results going forward. We don't see any necessity to have big marks this quarter by the country, and we believe this is the trend for the year as well.

Turning to page eight. We have the sales and trading business. Very strong results, BRL1.9 billion. Our second best quarter ever. And two things to highlight here, one is the strong performance of our commodities desks, which includes energy, agricultural products and metals and mining, and also a very good -- the flow from our clients. And we are very glad to see that even with the events that we have improved, the decline flow probably was one of the less affected of the client business that we have. And the results for this quarter showed that. And we believe we can continue to show that throughout the year.

On page nine, we have asset management. And revenues of BRL182 million, a very significant decrease from the levels that we've seen last year. And -- but I think we can show a few good numbers [ph] here. One is that even though our assets under management dropped from BRL230 billion, from two quarters ago, to BRL135 billion this quarter, very significant drop, we can say that the bleeding has stopped. We have seen in the past months, zero net new money or even marginally positive net new money and we believe this is the time [ph].

The redemptions that we are seeing this quarter are mainly redemptions that we were asking for during the crisis and materializes over the course of the quarter. Also I think, it's very important to mention that we had this BRL95 billion of redemption and we were able to pay all those redemptions on time without delay even for 24 hours any of the payments, without raising any gates [ph] on any of our fund, without having any side pockets or without having to close any of our products. As a matter of fact, our product line is exactly the same the product line that we had six months ago.

Also it's very important to say that our capability of managing the portfolio is intact. And I want to give you one example for that. One of our flagship funds call it GEM used to have between $4 billion and $5 billion of capital. It was reduced by negative [ph] 17%. And right now, it has already raising money, and has a positive return for the past couple of months.

So the losses which is more or less 3% that were incurred in the beginning of the year in a very tough market to downsize all the positions were almost all completely recuperated in the previews couple of month. This gives us a very good sign that our management capabilities remain intact even with our assets under management decrease [ph]. And as I said, this gives us a very good picture for the year going ahead.

On page 10, we have wealth management, where we had revenues of BRL1.2 billion, mainly BRL1.1 billion is coming from our BSI units and BRL100 million coming from our LatAm business. And here the picture on assets under management or wealth under management is more or less the same that we saw on asset management, some drop also in net new money, we had 8.3 negative new money for the quarter.

However, that bleeding has stopped. Actually we are seeing positive inflows in the past month [ph]. And also here, I would like to say that our BSI units performed very well in this quarter, because we had significant one-off event, which is the sale of the business unit, but also our LatAm business is very resilient, even with the drop in assets under management, we were able to maintain a very high level of revenue around BRL100 million.

Turning to page 11, we have principal investments. And here of course we have a very negative picture, with all three areas for different reasons, contribute negative revenues. First, global markets, we had negative revenues of BRL183 million and mainly the negative revenue here is the wind down of our hedge fund business, as I mentioned before.

Then Merchant Banking, negative BRL240 million and here the story is basically the cost of carry of our Merchant bank portfolio plus our loss related to divestment of our retail sector business that we have (inaudible) during the quarter. Real estate had a negative revenue of BRL96 million, mainly to carry cost and the asset sale related. I would like to mention here that we still have a position on BR Properties that was mark-to-market at market price at the end of the quarter, but the offer for BR Properties from a third-party to buy shares is going through the Bovespa as we speak.

So more likely they not will be able to sell a significant part of our stake at this level and at price that has been towards the market price that was verified at the end of the quarter. So we should expect a quality [ph] number of year for the next quarter.

If we change to page 13, we have the expenses ratios and our cost to income ratio stood at 50% and our comp ratio to 30%. I would say a little bit above what we would expect number. However, there is an explanation for that. And if you look at the BTG Pactual standalone numbers, I believe this depicts better what we have seen. Looking at salaries and benefits, we had 283 million of expenses this quarter compared to 287 from last quarter. So the cost reductions that we expect to see, it is not here, because we had cost related to the downsizing that we promoted through all the quarter [ph].

We don't expect any further downsizing to happen. However, we do expect this cost to go down next quarter by 20% to 25%, which is more or less the size of the downsizing that we planned [ph] in the quarter. Administrative and other, more or less the same picture, BRL307 million of expenses against 326 last quarter and this was impacted by the cost that we had related to the impact in the independent investigation commissioned by the independent committee, that most of the expenses were booked throughout this quarter.

This independent investigation, as you know, were made public to the market at a couple of weeks ago, it was performance by Quinn Emanuel, an US law firm and the results of the investigation where we found absolutely no evidence of any wrongdoing by the company or its officers on the alleged problems that were investigated in Brazil. So we of course don't expect to have these costs going forward. So Administrative and other line should also go down in the next quarters.

Page 15, we have our balance sheet analysis. Total assets on the balance sheet reached BRL234 billion, a decrease from last quarter and the shape of the balance sheet pretty much the same even though I would say more liquid and stronger.

Just looking at the total cash for the size of the portfolio is greater. Our coverage ratio 205% is greater than what it used to be. And if you look at the liquid assets compared with our equity or -- perpetual bonds 14.4 against 26 is at the lowest levels that we have seen in the past. And this shows not only the quality of our earnings, but also the quality of the work that we are doing on our balance sheet. And as a matter of fact, we intend to keep going -- even further on the simplification and getting our balance sheet stronger that we are going to show you at the end of the presentation, another step that we indent to implement to, as I said, keep this process going even further.

On page 16. We have our broader credit portfolio that reached BRL72.5 billion and basically the explanation here is the downsizing of our corporate lending and of course the FX variations on our wealth management portfolio, which is mainly related to the BSI unit. So I don't think any news here, but just another area that we are reducing outlook for.

Unsecured funding base reached BRL120.8 billion coming down from 137 last quarter and 162 from the previous quarter. And I think here, what we see is more or less of the same picture of the balance sheet, downsizing but with good quality.

We believe that demand deposit and other that are more volatile reduced more than the more stable let's say funding subordinated debt or the perpetual bonds. So we believe we are reducing our exposure to unsecured funding base in a very conservative way having a much better profile of funding going forward.

On page 18, we have our Basel ratio and value-at-risk. Basel ratio remained stable at 15.5%, exactly like it was last quarter and the value-at-risk increased to 1.16%. The value-at-risk is something that I said about the credit portfolio as well on the credit risk, and this is a proxy for market risk and you should expect and you have seen that at least two or three times in the last four years is that we increase and reduce our value-at-risk, as we see opportunity in the market or where we see the flow from our clients.

And I think it's always healthy to show an increasing credit risk or also with an increase in our sales and trading revenue. And again, that was the case this quarter. So we believe this is a normal dynamics of our business and we should expect that going forward without reducing and increasing every (Technical Difficulty) for market and client purposes.

Turning to page 19, there are two events here that we'd like to talk about. One is the commodities ringfencing and potential delivery to shareholders and the BSI combination with EFG and both of these measures, they go along the same route, which is simplifying our business and strengthening our balance sheet.

And I'm going to explain why as we go to the next page, but let's first give an update where those two [ph] transactions are. Commodities has been operating as a fully owned and independent entity, which we called Engelhart Commodities Trading Partners, since probably the beginning of this year.

The company has already been managed through a board and several sub committees as I said, as an independent company. We intend to deliver to shareholders a significant stake of this company, of course, we are still analyzing that. We still need regulatory approval, but of course, since we are presenting here that our clear intention.

We are still studying the structure, but just to make sure we will have the -- we will give all the shareholders the ability to either maintain their proportional stake in Engelhart Commodities Trading Partners or we had zero participation in ECTP, but increase their stake at BTG Pactual, with no book value dilution or accretion. We want to make that in a way that there is no gain or loss if the shareholders decided the stake on Engelhart Commodities Trading Partners, or BTG Pactual.

And of course we'll come up with more details when we are ready to do that and we have all the approvals. Also the DSI combination with EFG, we have some milestones to talk about. As you know, we have reached the final agreement with EFG on February 22nd. EFG, one of the conditions was to do a capital raise, which EFG announced and is supposed to close, I believe, tomorrow or the day after tomorrow.

However, EFG has already issued a statement today where the total capital increase was a little bit lower than 300 million Swiss francs which means that we are going to have a 30% stake on the combined entity further.

So that we are going to receive a small amounts on Tier 1 bond issued by EFG. So this gives more or less the borders of the transaction. And now we're just waiting regulatory approval and we have filed with most of the jurisdiction, so we should expect this transaction should be coming for conclusion soon. So what will happen to our balance sheet when we conclude this two transaction.

On page 20, we have what we believe is going to be our balance sheet. So on the first column, we have our March 31st balance sheet, assets of BRL235 billion, 23 billion of capital, Basel ratio of 15.5. When we complete the BSI transaction and the bank will deliver to shareholders Engelhart Commodities Trading Partners and we consolidated both from our balance sheet, what would happen? Assets will go from 235 to 133, so almost a drop of 50%, but our capital would decrease from 23 just to 19.3, a decrease of 20%.

What does that mean? Well of course, a much lower leverage ratio, which will go down from 10.1 to 6.9 and a much stronger Basel ratio which will go from 15.5 to 19.6. And I think that's the message that we wanted to pass. After we conclude all those transactions and the re-shape of our business that we initiated a couple of months ago, we are going to have a much streamlined balance sheet, very strong capital base of BRL20 billion and a very, very strong Basel ratio around 20%. And that's our goal for the next couple of quarters.

I think that's conclude our presentation. And I think we now can start for Q&A. Thank you very much.

Operator

The

Questions And Answers

Operator

Thank you sir. The floor is now open for questions from investors and analysts. (Operator Instructions) First question comes from Carlos Macedo with Goldman Sachs. Please go ahead.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thanks. Good afternoon, Kalim, Dantas, and Roberto. Couple of questions. First question on the Engelhard business that you're spinning off, could you give us any detail on performance there in terms of revenues, expenses, earnings? So that we can get an idea of what's actually getting spun-off and we can do our math, better I understand what the impact would be and try to replicate what you have here.

Second question more of a medium term question you -- you know, once the sale of your size concluded and Engelhard spun off, as you said you'd be up to 20% in terms of common equity Tier 1, sorry, -- your capital ratio, assuming that -- at that point, you know, their loan book is also lower than it is now.

You even add further to that, is there a thought of what the right size for capital is for this business? I mean what do you still -- how much capital you need to run the businesses that you'll keep in the bank? And what would you do with the excess if you believe there is any? Is there going to be via buybacks? Is there a chance that you do a capital reduction, I mean, what are the thoughts?

A - Marcelo Kalim {BIO 16142515 <GO>}

Hi Macedo [ph], thanks for the questions. So the first one Engelhart Commodities Trading Partners, we were talking in the call in Portuguese, a little bit about that, just to give you a rough number. Revenues for this business for the quarter were around BRL800 million, it's around the sales and trading business. So it's more or less 40% of the revenue this quarter. I would say that this quarter probably is a very good quarter for commodities. So you should expect, on average, that would be a little bit lower than it was this quarter.

Regarding the other metrics, return on equity and costs, I can give you a rough number. None of our business line, they have a very much different cost income or return on equity than the other. So let's assume we are recording an 18% or 19% return on equity this quarter, all of the units, they have either 20% more or 20% less than that.

That's more or less that we (inaudible) our businesses are. Of course when we are ready, when we need to do this transaction, we are going to show you financials for the separate metrics [ph] and then you can have a very clear picture of what we are really talking about. But as a rule of thumb, use this 20% more or less return on equity for each of our business units and for sure, ECTP falls into that range.

The second question about what we do, we discussed with a very interesting one. As you know, we are in the middle of a buyback, should we expect the buyback to continue? I can say, yes. Looking at the price of our share which is trading between I don't know 19, 20, whatever the price and our book value (inaudible) 26. We think it's a very good use of capital for all the shareholders to use excess capital to buy the shares and let's say get this profit. Will we be able to do that? I don't know, depends, of course on the shareholders' willingness to sell that price.

Divest or give capital back to the shareholders also, that's a consideration, but if you look at our history, and we will do the same analogy that I did with credit risk and market risk, we can do with capital. There was a point in time in our history, where we saw a lot more opportunities to deploy capital than we have. That's why we did a private placement in 2010, and exactly the same reason we did the IPO in 2012.

So probably now in -- we are in the other direction. We have a very high Basel ratio, which means that we have more capital than we are using the business. I believe 20% Basel ratio for banks like ours is too much and probably you agree that's why your question will have more capital in our respective [ph] right now.

However, I see Latin America in general in Brazil particular, probably going to better 24 months going forward than the previous 24 that we had somewhat like (inaudible). We will have a space to deploy this capital in our own business. However, we will have to see how that happens, it's not a decision that we're going to take in the very near future. But I think, we are in a very good position to decide that when time comes, either distribute to shareholders, deploy on our capital or buyback shares if the shares are available to be bought back.

So I think from a strategic view point, we are in a very comfortable position as I mentioned. And by the way, I think all the three are feasible. If the market conditions present themselves then we continue our, let's say, growth path and deploy capital may I say, widely as we have been doing in the past.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you, Kalim.

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. Marcelo Kalim for his closing remarks.

A - Marcelo Kalim {BIO 16142515 <GO>}

Thank you everyone again for attending this call. We'll hope to see you in next quarter. Have a nice day. Thank you.

Operator

Thank you, sir. This does conclude today's presentation. You may disconnect your lines at this time and have a nice day.