

Q1 2017 Earnings Call

Company Participants

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

MANAGEMENT DISCUSSION SECTION

Operator

Good morning and welcome to the First 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 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.

Today, we have a simultaneous webcast that may be accessed through the website, www.btgpactual.com/ir and Engagex platform. There will be a replay facility for this call for a week from May 10 through May 16.

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 morning, everyone. Thank you for joining our call. If you turn to page 3 of the presentation, we have changed a little bit the format, and we want to start with the key highlights of the quarter. It's important to remember that now we're talking just about Banco BTG Pactual as we did the split of the unit in the last quarter.

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The first point to highlight is the very solid profitability we had in the quarter. We did an adjusted return on equity of 18.7%. Important to mention here that now that we are talking just about Banco BTG Pactual, we also decided to start reporting in the same way as our peers report so that it becomes easier for comparison purposes. So we are reporting return on equity adjusted by extraordinary expenses and by goodwill amortization as well as a tax adjustment just as the peers that we are compared to report.

The second point to highlight is the maintenance of a highly conservative balance sheet with low leverage, where the best way to see this is we had a Basel ratio of 19.5%. Basically, the reduction the - a bit above 21%. We had at the end of Q4 to the 19.5% now is the phased-in entrance of the Basel III policies that are coming in - that came in at the end of current year.

The third point to mention is the very stable secured funding base that we have this quarter. Dantas will talk about that a bit more when he goes through the details of the numbers.

The fourth point to highlight is that we have a very strong performance in both our Asset Management and Wealth Management business units. We think that the best way this is seen is the historically high net new money for the quarter we had in Wealth Management and this is - shows our platform regaining operational leverage exactly as expected in the call we had last year - with the end of last year.

And fifth, we had a very strong performance by our Investment Banking franchise which performed well on the back of a market pickup on activity in the region.

Turning to page 4, we can see a bit of the details of the highlights. So we finished the quarter with revenues of BRL 1.66 billion and net income of BRL 720 million. As said previously, we finished the quarter with an annualized return on equity of 18.7% and adjusted net income of BRL 843 million.

Also, we were very satisfied that our cost-to-income and comp ratios went back to the historical aggregate of 42% for cost-to-income, 20% for the compensation ratio for the quarter. And finally, assets increased a bit in the quarter from BRL 112 billion last quarter to BRL 125 billion. And as mentioned previously, Basel was 19.5%. And we finished the quarter with shareholders' equity of BRL 18.3 billion.

Turning to page 5, you can see the breakdown of our revenues between business units. It's very spread between all our business units, which make us very satisfied. So roughly 10% coming each from Corporate Lending and Investment Banking, Sales and Trading was a very strong performance of 35% of revenues, and Asset Management starting to go back to its traditional between 10% and 15%; now at 6%, of revenues with Wealth Management at 5%.

Worth mentioning here, our Principal Investments at 7% of revenues even though we think that, over time, as we continue simplifying our balance sheet and divesting of the few assets that we have especially in the Merchant Banking portfolio, this number should tend

to decrease over time. And Participations where, here, we include Banco Pan, Pan Seguros, ECTP, EFG, the main performance here coming from our - the bank's participation and ECTP.

With that, I'll pass the word to João Dantas and then I can come back for questions at the end of the call.

João Marcello Dantas Leite

Thank you, Roberto. Thanks for everyone participating on the call today. So as Roberto said, we had a very strong performance from our business areas, and in the next page is we'll analyze the fundamental drivers of the stronger revenues in each of the business areas.

Starting in page 7, we have the performance of Investment Banking, which had revenues of BRL 152 million in the first quarter of 2017 compared to BRL 115 million in the previous quarter.

Here is the important highlights. First is our market position, which remains strong in the region, a winning market position consolidated throughout the years.

Second highlight is the DCM revenues that continue at very high levels. We see LatAm corporates having been frequent issuers and it was a lot of access in issuing international markets, and our DCM team is very actively engaged in those issuances.

Also, a highlight is the ECM revenues, which, in the first quarter of 2017, were higher than the full year of 2016. This comes in the back of the capital markets recovery for Latin America and for us is an indication of what could be the year of 2017.

And lastly, we have a little less M&A activity in the region in the first quarter, although we continue to see strong appetite for assets in Brazil coming from international investors.

Moving to page 8, we have the performance of the Corporate Lending business. Revenue is coming down to BRL 155 million as compared to BRL 177 million in the previous quarter.

The first thing to highlight here is that we have lower contribution from the NPL book. In the NPL book, revenues are event-driven and not scattered on an accrual basis. So, we didn't have divestment fears or renegotiations in the quarter, which led to a lower contribution from NPL.

Even though we have a very strong buildup of our NPL capabilities, especially through Enforce which is the new corporate NPL platform that we are forming in a joint venture with partners, which is very well positioned in the current moment of the Brazilian economy where we are coming out of a recession period and where we see a lot of optimism going forward and more access with capital deployment. So Enforce is building up nicely in that moment.

Also, our Corporate Lending portfolio is stable. You see here around BRL 20 billion of Corporate Lending, where we see spreads above historical averages and still very high and comfortable levels of provisions.

Moving to page 9, we have Sales and Trading. First, I'd like to highlight there's a vertical line here showing that until the third quarter of 2016, the performance included revenues from our commodities platform, ECTP. And then from the fourth quarter of 2016 onwards, we see only the performance of our Sales and Trading activities at the bank.

Growth of revenues from BRL 249 million to BRL 586 million in the first quarter of 2017 is driven by stronger volumes of flow trading (00:10:34) especially Fixed Income but also in Equities and FX. In Brazil, this revenue growth comes in connection with greater visibility of the movement of convergence of interest rates which we expect to continue along 2017.

Moving to page 10, we have here Asset Management revenues at BRL 107 million in the quarter compared to BRL 113 million in the previous quarter. Revenues are basically stable, but the first quarter composed almost exclusively of management fees. While in the fourth quarter, we have some capture of performance fees as well.

Not only revenues are stable, but also we are very happy to report the positive net new money of BRL 500 million. And I believe that above that, we also have an important aspect that we observe now a shift of the asset allocation from clients, moving from liquid and short-term fixed income to more long-term fixed income, equities and hedge fund strategies, which also means higher management fees and potentially performance fees for the business.

We see that coming not only from the increased appetite and investors' confidence, but also from the very effective performance of our French Asset Management franchise across asset classes. I would highlight here the performance of our Global Emerging Markets front, GEMM, which year-to-date has more than 5% net return already net of fees and of Absolut, our Equities franchise in Latin America which is also performing very well.

Moving to page 11 where we have the Wealth Management business. Revenues are at BRL 87 million compared to BRL 85 million of the previous quarter. What we see here that is more important is a very positive, significant net new money trend. We have (00:12:43) the third quarter of 2016 significant asset gathering in every current quarter as mentioned by Roberto already. We have a record high net new money of BRL 3.7 billion.

As our Wealth Management revenues, they are predominantly composed of management fees, but positive net new money is also an indicative of potential growth for the recurring fee base. But we also see from investment fees potentially growing as a result of more flow and more client activity also in Wealth Management trading lines.

Moving to page 12, we have Principal Investments. We have positive revenues of BRL 13 million from Global Markets, which is basically the positive returns from the fee allocation

that we have in our funds, which is a small allocation compared to what we had in the past. Then we expect to keep like that.

In Merchant Banking, results are positive and driven essentially from the mark-to-market in our investment in Eneva. Actually, in the Merchant Banking portfolio at the bank, we have now fewer investments with a firm reduction of exposure.

And in Real Estate, no highlights. We have a negative result of BRL 12 million, which is basically the allocation of funding cost to the positions. We have no mark-to-market, no divestments, nothing to highlight in the quarter.

With that, we conclude the performance analysis of the business areas and we move on to the expense analysis on page 14. Here, as you can see, for the first quarter of 2017, we highlighted the two main ratios which are the cost-to-income ratio of 42% and the compensation ratio of 20%. Important to note here that expenses are stable, under control, and we keep operating leverage at the bank for the growth that we expect to see throughout 2017 so we can grow assets under management. We can grow transaction volumes, and we have enough operating leverage to support that growth.

We also see that the ratios, the cost-to-income ratio and compensation ratio, have converged to our historical efficiency levels which make us happy that everything that we needed to adjust has been concluded.

Also, we see an adequate income tax rate at the current quarter. We have 24.9% tax rate, which is the blend rate from all our businesses in Brazil, LatAm and globally. And this also indicates a stronger quality of the earnings because we have not only more net earnings in the quarter than we had in the previous one, but also in the previous quarter of - the fourth quarter of 2016, we had a positive contribution from the income tax line since we have declared JCP, which is the deductible tax dividend in Brazil. In the current quarter, we have a more normalized tax rate and still stronger earnings, which underline our strong performance in the business areas.

Moving to the analysis of the balance sheet on page 16. First of all, this is a very stable picture of the balance sheet. We continue to run our balance sheet with a very conservative and prudent approach, very liquid and highly capitalized. We went from BRL 111.8 billion to BRL 125.2 billion of assets. The leverage is still very low at 6.8 times equity, and the increase in the balance sheet comes essential from the flow business (00:16:39) or from more trading activities from clients.

As you can see here, the asset line that increased the trading portfolio and assets financed through repo, which are indicative of more activity with clients. These assets, they are self-financed. So, the increase in the balance sheet did not put any pressure or required any additional unsecured funding to our business.

And also, important to highlight that the stronger our balance sheet, the more we see our clients resuming business with us. So we expect to keep the balance sheet exactly like this throughout the year, extremely liquid and highly capitalized.

Next page is page 17 where we have the analysis of our broader credit portfolio. Here, you see a growth from BRL 24.3 billion to BRL 26.5 billion, which is a small – on the broader credit portfolio, which is in line with the growth in the Corporate Lending portfolio. And not only that, it's also coming from the accruals.

So we see more opportunities to deploy credit in the second half of 2017, but it's important to say the portfolio today is quite small compared to our historical averages. Today, our portfolio is at 1.4 times solid (00:18:04) equity, which we consider adequate for the moment.

Moving to page 18, we see the unsecured funding base and this is a reflection of the leads of the financing from the business. So we have a stable funding base of BRL 33.6 billion coming from BRL 34.2 billion in the previous quarter. This represents roughly 218% coverage of funding to the credit portfolio. So we have more than 2 times unsecured funding for our own balance sheet credit operations, which is more than enough to support our funding needs.

Also, we have seen throughout the quarter and throughout the recent period coming to the – from the end of 2016 that the renewals are now very stable. Not only renewals of our funding lines, but also of balance sheets and by letters of credit. So, unsecured funding now is stable and completely back to normality.

And in page 19, we have an analysis of risks and capital usage. On the left part, the chart indicates that our Basel ratio is at 19.5% coming from 21.5% in the end of 2016. This is essentially coming from the implementation of Basel III as Roberto mentioned. As we saw also, the credit deployment is basically stable. Our credit portfolio was not increased, and our market risk deployment has reduced. So you see that we keep the balance sheet at a very strong capitalization at 19.5%, and this is what we expect to keep throughout the year.

Also, worth mentioning that the average VaR as a percentage of equity was reduced from 79 basis to 65 basis, which is BRL 117 million of average VaR in the quarter, which indicates a lower appetite for capital deployment in markets.

And that concludes our analysis. We will now go to Q&A. Thank you very much, and we expect you have questions. Thank you.

Q&A

Operator

The floor is now open for questions from investors and analysts. Our first question comes from Felipe Salomao of Morgan Stanley (00:21:01). Please go ahead.

Hi, everyone. First of all, congrats on the results. I have two questions. The first one is regarding Investment Banking and Sales and Trading revenues. I know it's a little bit difficult to provide a guidance in terms of revenues on an annual basis for these two lines,

but if you could share your thoughts or your expectations in terms of revenues coming from Investment Banking activities and Sales and Trading activities for 2017, that would be great. And then I will go to my second question.

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

Thank you, Felipe (00:21:45). As you said, it's very hard to provide guidance. However, as Dantas mentioned, this year, the activity in Investment Banking has picked up and the other indications we have is that this pickup is something prevalent. Probably not to the first quarter we replicated every quarter, but we are expecting to see some growth of - compared to last year, which was very similar to the previous year, in Investment Banking.

In Sales and Trading, it's still hard. As you know, a lot has happened because we distributed Engelhart and the business is now back to normal. I would probably say this quarter result, plus/minus some percentage, should be the average of the next quarters. But it's very hard to provide quarter-by-quarter guidance. But if you look at year-end, maybe to annualize something close to this quarter seems reasonable to me.

A - João Marcello Dantas Leite

And Felipe (00:23:00), just to add to what Roberto said, I think also that it's very important that our balance sheet now is very strong, very well capitalized than MiFID (00:23:11) because it puts us in the comfortable position to be able to support client needs going forward.

We see more - as we said, more demand and more confidence from investors around the globe. For LatAm, especially for Brazil, there are still important things to happen. These important things that will happen in the country we believe in the upcoming months will count a lot for that investor confidence to translate into investment opportunities. And we will liquid that solid balance sheet, reposition ourselves in a very good place to support client needs that we start to see from more meetings, more travels and more interest in the region.

Let's go to your second question.

Q - Operator

Okay. Thank you, Roberto and João, for the answers. So, my second question is about BTG Digital. Those of us who live in Brazil have noticed that advertisements of BTG Pactual Digital have become more constant. Can you please share with us, I mean, a little bit of the rationale of BTG for investing on this online distribution channel of an investment product? And also, if you could share, I don't know, inside of expectations in terms of revenues coming from this business unit in the mid to long run, that would be great for us. Thank you.

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

So the rationale is that we already have the product setup and the service setup in our Wealth Management business. And by trying to target the upper retail market with Digital,

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we're doing that at a very low marginal cost. It's basically IT development and marketing. And important to say that what we have felt is that the marketing campaign has had a very positive impact in our other business lines other than Digital.

As we said when we launched this business, our target there is to have 10% of market share. We estimate this market to be roughly around BRL 650 billion assets under management. So we think that this business can reach roughly BRL 65 billion of AUM. And probably it's fair to say that the ROA there is probably a bit higher than Wealth Management given the products which are distributed in this platform.

We're currently consolidating these numbers within Wealth Management because it's also a target for this interest. As everyone knows, (00:26:01) we can discuss whether we want to show these numbers separately or not.

Q - Operator

Okay. That was very helpful. Thank you very much and congrats again on the results.

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

Thank you, Felipe (00:26:14).

Operator

Thank you. That brings us to the end of the question-and-answer session. I will now turn the floor back to Mr. Roberto Sallouti for any closing remarks.

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

Thank you very much for, once again, joining our quarterly call. We hope you have a great day and hope to see you at our next quarterly call. Thank you very much. Bye-bye.

Operator

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

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