

Q1 2018 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 First Quarter of 2018 Results Conference Call of Banco BTG Pactual. With us here today, we have Roberto Sallouti, João Dantas, Pedro da Rocha Lima.

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

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 facility for this call from May 3 through May 10.

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 depends substantially on changes and 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 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 afternoon or good morning to all of you. Before we jump in to the first quarter results, we would like to make some qualitative comments on our business on the first quarter.

If you could please turn to page 3 of the presentation, we would like to make some highlights of the trends that we are seeing. On this - number one, we had in the first quarter a record net new money inflow into our Wealth Management business, closing our Wealth Management business with over BRL 100 billion. Second, we also had very strong net new money inflows in our Asset Management business in the first quarter. Along with that, we are also seeing a shift in the portfolio of clients from money market or fixed income funds into credit, equity and hedge funds. Number three, we also saw in the first quarter an important growth in our unsecured funding base which grew around 10.5% (sic) [10.6%] (00:03:03), allowing us to accelerate the growth of our credit business.

Finally, what we will also show in a couple of slides is that it is very easy to know how much capital each of the financial institutions that are part of BTG Pactual's results consumes and how much each of these institutions contribute to the bottom line. So, we will show the return on equity of Banco BTG Pactual, our stake in Banco Pan and our stake in EFG International. And you're able to see that the Banco BTG Pactual stand-alone return on equity for the quarter was above 20%.

And talking about the participations we have, Banco Pan reported earnings yesterday. It was the fifth consecutive quarter of positive operating profit and it continues to increase its efficiency indices, its digitalization. And we expect that it will continue to have - not only continue the trend of operating profits, but we expect them to grow quarter-by-quarter over the next few quarters.

And finally, EFG announced also that we are reflecting in our earnings this quarter the results for the second half of last year, and these were affected by the one-off integration costs of BSI.

If you then turn to page 4, we can talk a bit about the main highlights of the first quarter where we delivered for the whole of BTG Pactual an adjusted return on equity of 14.2%. We had total revenues of BRL 1.3 billion and an adjusted the net income of BRL 660 million. This means the net income per unit of BRL 0.74 and an accounting net income of BRL 600 million.

Our cost income ratios were in line with our historical average with the cost-to-income ratio of 44%, and the compensation ratio around 22%. And finally, our assets grew this quarter to BRL 146.3 billion. Our Basel ratio ended the quarter at 16.3% and our shareholders' equity at BRL 18.7 billion.

If you turn to page 5, you will see the distribution of our revenues for the quarter, which are basically in line with our recent history. However, what we think will happen over the next few quarters with the underlying trends that we are seeing in our business is that as a

percentage of revenues, corporate lending, Asset Management and Wealth Management should grow. Investment Banking should become relative – continue relatively stable and sales and trading should diminish as a percentage of total revenues.

Turning to page 6, you have what I mentioned in our opening statements which is the return on equity per the different financial institutions within BTG Pactual. So, Banco BTG Pactual standalone had a return on equity of 20.5%. Banco Pan had a return on equity in our stake of 6%. And EFG International had a return on equity of minus 11% given the one-off integration costs.

I will now pass on the floor to João Dantas who will give some details on each of the business areas. Thank you.

João Marcello Dantas Leite

Thank you, Roberto. Thank you, everyone, for joining our call. So, as we said, the main highlight of this quarter is the performance of our business areas and I'll take the opportunity to go through the drivers of the performance in highlighting some aspects qualitative and quantitative aspects of it. On the first page, page 8, we have Investment Banking. All in all, it's a good quarter for Investment Banking. We have seen more activity in DCM and M&A. Very little activity in the first quarter in equity capital markets. We have maintained our number one position in M&A and number three position in the quarter in ECM. This higher level of activity that we see comes in an environment that is more susceptible to changes in humor of the foreign investors especially. Of the BRL 110 million of revenues, we have 50-50 split between M&A and ECM. And during the second quarter, we see already more activity in ECM and continuing strong activity in all the – in the other two areas.

Going to page 9, here we have corporate lending. The first highlight is the right chart on the page which is the growth of the corporate lending portfolio. Year-on-year, we have gone from BRL 20.1 billion to BRL 22.5 billion which is a 12% annualized growth, which is of course in terms of origination much more than that because we have amortizations and redemptions during the period. The revenues reached at BRL 171 million basically coming from corporate lending, almost zero contribution from distressed assets, non-performing loans or special situations portfolio which doesn't mean that we don't have a lot of activity happening there, just means that we didn't capture any revenues in this particular quarter.

The corporate lending spreads continue stable at slightly lower than 3% and the renewals and new origination come in line with the pre-existing spreads of the portfolio. Our loan loss provision went from 4.9% of the total portfolio to 5.1% of the total portfolio and our non-performing loan ratio, which is the overdue above 90 days, has reduced slightly in the period.

On page 10, we have sales and trading. We reached BRL 551 million of revenues in the quarter, slightly below the previous quarter of BRL 691 million. Our rates desk performed well. It's important to mention there we didn't feel the impact of interest rates reduction in Brazil. The rate performance and volumes continue to go well.

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FX desk also produced solid performance in the quarter. The decrease in revenues is more in the quarter compared to the previous quarter is more explained by the performance of our energy desk that performed quite well in the fourth quarter and went more to a normalized rate of performance in this quarter.

Also, we had good performance from equities and also from our commissions and brokerage revenues, which have a small contribution to the total mix of revenues in sales and trading, but is an important indicator of confidence from our clients and investors, especially foreign investors who have particularly been picking up volumes with our broker dealers across LatAm.

On page 11, we see Asset Management. And here, we have a few important highlights. First, you see on the right part of the page that we went from BRL 144.9 billion to BRL 163.7 billion AuM. This is a 13% growth quarter-on-quarter, which is a remarkable performance.

If you look at year-on-year, we went from BRL 120.1 billion to BRL 163.7 billion, which is 36% growth in AuM. This comes from a BRL 25.3 billion net new money in the quarter which corresponds to about 17%, 18% of the average AuM in the period. So, it's a pace of asset of gathering that we haven't seen in the past. This has led to management fees of BRL 125 million. The revenues in the quarter are basically coming from management fees. As you know, we typically capture performance fees in the fourth quarter. So, the management fees in the first quarter of 2018 represent already a growth on the run rate compared to previous quarters.

The main drivers for this remarkable growth in Asset Management are three. First is this portfolio relocation trend that we see in Latin America. As we saw rates converging down to this level of 6%, we see clients looking for longer maturity and higher yields, so looking for the types of products we offer in our Asset Management platform. Second is outstanding performance in all asset classes that we manage within top quartile or even top decile of performance, which is leading to us gaining market share. And then the digital distribution which starts to kick in and then help us in the asset gathering in Asset Management.

Moving to page 12, we see a similar picture here for our Wealth Management business. Starting from the right part of the page, we went from BRL 86.9 billion to BRL 100.2 billion of wealth under management which is 15% growth in the quarter, quarter-on-quarter 15% growth and year-on-year 25% growth from the BRL 79.9 billion of wealth under management that we have in the end of the first quarter in 2017. This comes pushed by net new money of BRL 9 billion in the period which is about 10% of the average wealth under management of the year which is also a remarkable pace of asset gathering for our business.

Revenues reached BRL 104 million in the quarter which compared to the first quarter of 2017 represents a CAGR of 20%. With the run rate growing more towards the end of the period as we have more asset gathering towards the end of the period, we could expect the run rate for Wealth Management to continue to expand.

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Growth drivers here are similar to Asset Management of course is first driven by portfolio relocation, very strong in the country. This is a transformational change in Asset and Wealth Management that we are seeing. With this new level of interest rates, there's a lot of demand into, as we said, higher yields and longer maturity.

Product performance also benefits also the quality of service from our Wealth Management platform is differentiating our offering and helping us open new accounts and gather more assets from clients and also digital distribution starting to kick in and help us on the asset gathering.

Next page on page 13, we have Principal Investments. Not a lot to highlight here. We have small, positive contribution from global markets. Basically, negative contribution from real estate coming from internal funding cost allocation and a positive contribution from our Merchant Banking portfolio, which reflects basically our share of profits on investments. And the main highlight here is the continuing process of divestments. We're divesting - the main process now is the divestment from our joint venture with Petrobras in oil production in Africa. And this process is going well and well-advanced.

Moving to section 2, a few comments on our efficiency ratios. As you see, our total operating expenses reached BRL 572 million in the quarter, 23% down from last quarter, 19% down from the first quarter of 2017. This leads to a cost income ratio of 44%, which is a nominal cost income ratio. If you look at the normalized cost income ratio, which adjusts basically for one-off administrative and other expenses, which are basically legal fees, the efficiency ratio would be 37%. We believe this is a efficient way, efficient and adequate cost income ratio, and represents an efficiency running - efficient running of our business.

Now, on section 3, let's look at how this growth trend in our business is impacting our balance sheet. Starting with the liabilities, we have seen an increase of 15% from BRL 126.6 billion to BRL 146.3 billion. There's growth in unsecured funding of 12%, which is basically us issuing deposits in local currency, mainly reais but also Chilean pesos in our investment bank in Chile. And there's a growth of 10% of our secured funding including repo financing.

On the asset side, we don't have structural - so much structural asset growth. If you look at credit and other assets and illiquid assets, it's been pretty stable in the period, small growth. What we have is more growth on assets financed through repo and trading portfolio, which is growth on the liquid part of the balance sheet. And that growth came with an increase in consumption of credit risk and a reduction in consumption of market risk as we will see further down. And we also had an increase in our liquidity and our cash pool (00:18:07) due to the increase of unsecured funding.

Next page, we see the broader credit portfolio, the behavior of the broader credit portfolio was in line with our corporate lending portfolio, which is the main component of credit exposure. So, we've been consistently growing throughout the quarters reaching BRL 29.4 billion of expanded credit portfolio or broader credit portfolio.

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On page 19, we have unsecured funding base and a few highlights here I think are very important. After a significant growth of our securities issued in – from the third to the fourth quarter of last year, as you remember, we successfully issued senior unsecured notes in international markets denominated in dollars which led to the increase of our securities issued from BRL 7.4 billion to BRL 9.7 billion. We now experience a 37% growth in deposits. These are basically, as I said, local deposits issued in Brazilian reais and Chilean pesos, mostly Brazilian reais. And this is a very strong pace of funding growth which represents also an increase in liquidity as we have been slowly – more slowly deploying this additional asset capacity into credit.

Also important to highlight that our funding cost as a percentage of CDI is stable; and naturally, as CDI is reducing, the nominal cost of funding is also reducing in line with that.

And finally on the last page, you'll see Basel ratio and VaR. Basel ratio went from 18% in the end of the year – in the end of last year to 16.3% this year which still a very comfortable Basel ratio. This is impacted by the phasing in of Basel III and also by the increase of capital consumption by credit risk which is in line with the growth of our total assets which was partially compensated by a reduction on utilization by market risk.

As you'll see on the market risk chart, our average VaR as percentage of average equity went from 0.65% to 0.57% and that is – those are the drivers for the capital ratio. So with that, we close in our comments. Thank you very much for joining. And now, we are opening the line for questions. Thank you very much.

Q&A

Operator

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

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

Thanks. Good afternoon, gentlemen. Thanks for taking questions. I have a couple. First, you commented Investment Banking results were a little bit lower sequentially but still pretty solid.

Looking through the end of this year, the World Cup coming up and then elections in Brazil, do you think – how do you think about these results going forward? Is this, the last couple of quarters, the high watermark and we should see a little bit less activity going forward given the events that are coming or should we expect the levels to remain relatively solid over the next few quarters?

Second question, you mentioned the online platform having an impact, at least some impact on the origination for your Asset Management operation. Could you talk a little about that? What stage of development are you in? What do you expect to get from this online platform in terms of contribution for net new money and overall flows, revenues

particularly in light of the success that some peers like XP have had in the market with a similar online platform? Thanks.

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

Thank you, Macedo. Addressing your questions, first, on Investment Banking, we do expect the level of activity to maintain itself. What we have seen is that for M&A and for specific equity capital markets transactions which are not dependent on the macro scenario, these have been quite resilient given the international scenario or the political scenario locally.

And we have also seen that the new level of interest rates in Brazil has also, how I say, warmed up the debt capital markets locally. So, naturally, Investment Banking by nature is a bit volatile. But to give you an opinion right now that we would expect the pipeline is one that expects - that makes us expect this level of activity to continue. But we will only see that as things advance. As you know, deals can occur or not occur.

Talking about our digital initiative, we are quite satisfied with it. We are - in the next few weeks and months, we will finalize rolling out the full platform we have for investments. So, we do not have the full platform out yet. But every month or every few weeks, we have been improving (00:24:13) the user experience or adding our new products to the platform.

The growth has been continuous. The benefits to our operational efficiency, our operational leverage and our existing Wealth Management business have been enormous. And we are very optimistic that over time we can get a significant market share in this upper retail market on the investment part, which means that over time we think that we can probably - if we're successful, we can probably double our Wealth Management business just from this new market that we're accessing not even talking about the growth in the traditional Wealth Management business. But we're not ready yet to disclose details as we want to first make sure we have our full platform operational. But hopefully, over time, we can disclose a bit more about this.

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

Thanks. And then doubling is an impressive number. Is there a timeframe that we should - that we can attach this even if it's not a specific one and I'll say one to three years or five to seven years or how what - just a general timeframe?

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

Probably three to five years.

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

Okay. Perfect. Thank you.

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

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Thank you.

Operator

And at this time, I'm showing no further questions, so I will conclude the question-and-answer session and return the floor to Mr. Roberto Sallouti for his closing remarks.

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

Thank you all once again for joining our quarterly call. As mentioned previously, we're quite optimistic with the underlying trends that we are seeing in our business, and we look forward to seeing all of you at the end of the second quarter. Thank you very much and have a great day.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may disconnect your time - you may disconnect your line at this time, and have a nice day.

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