

Q1 2015 Earnings Call

Company Participants

- Andre Esteves, Chairman
- Marcelo Kalim, CFO

Other Participants

- Jorge Kuri, Analyst

Presentation

Operator

Good morning, everyone. Welcome to the First Quarter of 2015 results conference call of BTG Pactual. With us here today we have Mr. Andre Esteves, Mr. Marcelo Kalim, Mr. Joao Dantas, Mr. 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 7th through May 13th. 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'll turn the floor to Mr. Andre Esteves, who will begin the presentation. Sir, please go ahead.

Andre Esteves {BIO 1939152 <GO>}

Good afternoon, everybody. Thank you very much for being on the call with us once again. We will announce here the First Quarter results of 2015. And we are glad to say that

we posted record revenues of almost BRL2 billion, more precisely of BRL1.961 billion, the best ever, 24% above Fourth Quarter of last year.

And also a record pre-tax profit, 28% above the same period of last year. These implicated in a BRL854 million net earnings, which is a strong earnings of the second best in our history, even in a relatively weak economic environment. So this shows once again I think the quality and strength of the platform and the business model. And of providing this kind of results in weak capital markets in Brazil and Latin America.

This was a return on equity of unrealized at roughly 18%, net income at BRL0.94 per unit. Regarding the expenses, cost income at 40%, which is a very good number. Compensation ratio at 20%, also a very good number. And we had total assets of BRL224 billion, slightly higher than last year.

The Basel ratio was 16.7%, well above the regulatory requirements. And our shareholders equity continued to grow. And now we ended the quarter at BRL19.2 billion, also the highest in our history. VaR slightly increased to 59 bps of average shareholder's equity, which is, as I said, slightly higher. But still a relatively low number.

Moving to page 4, where we talk about each of the businesses. Our CFO, Marcelo Kalim, will talk in more detail about each business line. But I'll give you conceptual highlights. First investment bank we had BRL41 million, which is a weak result.

It's generally First Quarter is not very strong. But in Latin America it was a very weak capital market activity. We didn't have any IPO in Brazil; we didn't have any euro bond issuance in Brazil. So these are very strong signals of a weak market.

We think that we will deliver the expected results during the year, even though that we don't expect strong capital markets. But we have a very strong M&A. As you know, these products are counter-cyclical. And in Brazil since and LatAm the cycles are very important. And we expect to make the money from the strong M&A pipeline.

On corporate lending, the results were quite strong. In the year we had the normal business that we had expected, progression, plus some additional revenues coming from NPL portfolios that were acquired in the last 12 months. Even though these NPL's they are -- we can see they are non-recurring. But we do expect them to kick in, in other quarters this year. So we are optimist with corporate lending results for this year.

Then we have season trading where we had BRL1.168 billion of revenues, the largest ever in our history. And here's basically a combination of factors. So it's not one specific line of business. But I would say that the volatility with conversion, a lot of people that wanted to bring money in, others that want to take money out on the different markets, increased clients' activity. And arbitrage opportunities. And basically all the cylinders here of performance. So commodities, FX, interest rates. And equities. And the geographies' performance. So we basically made money in all the geographies that we act in Latin America.

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In asset management, we had the BRL207 million of revenues, which is lower than last year. Important to say that we are with more assets, more products. And much higher management fee. The difference is basically we didn't charge performance fee in this quarter.

These numbers almost all of that composed by management fees, which are much higher than 12 months ago, or even last quarter. So we like the evolution of the business. Of course in the future we expect to collect again performance fees. The important topic here is that the management fees are an all-time high. Kalim will talk about that.

Wealth management was also strong results, the best ever in our history. Also we are in all-time high of assets under management. And revenue. So we like the evolution of this business. And not only Brazil. But our countries like Chile, Peru, Colombia, Mexico. And Argentina, we are having some important growth here.

Then we have principal investments where we had a, we were positive in real estate, basically flat-ish in global markets. And negative in merchant bank. We prepared this specific chart on merchant banking since we had some questions during the quarter around our private equity portfolio. You can see that it was interesting to use sometimes here to explore more of these business units.

(inaudible) slightly negative. And interest in other very positive here is simple mathematics. As you know, our balance sheet, we have very low tax shields of goodwill. So it's basically the CDI that is now in high on our liquid cash.

So to conclude my introduction, moving to page 5, we brought merchant bank as a relevant topic here. Just to give a little bit of historical perspective. And maybe give some qualitative guidance in terms of direction.

So we started to report this business the same way that we do today, since 2011. And we were profitable every year since then. So in 2011, 2012, 2013, 2014, all of these years we were profitable. And in this picture here, we highlighted some of the transactions, or divestments that we did. And were the core responsible for these results.

This year we had a very negative quarter, with BRL537 million loss. Basically was a provision in Sete Brasil, which is an important investment that (pose it) finance basically investment that is under certain restructuring.

So we decided to do a 25% provision. And this was the most important negative component, around BRL300 million. We had BRL1.1 billion. And now we have about BRL800 million, in terms of investments.

Looking ahead, we don't expect anything different from our portfolio merchant bank from the history. So we do expect a positive year. And as most of you saw, we announced a very important transaction last week where one of our core investment companies, Rede D'Or, got an investment from Carlyle of BRL1.750 billion for about 8% of the company, a

primary investment. And this implies something around BRL21 billion, or BRL22 billion of post-money valuation.

The difference of our accounting, what we have booked in our account, to the price of the Carlyle deal, is about BRL3.5 billion. So it's a very significant profit that is inside the books. Of course it didn't happen in the First Quarter, it happened -- the transaction is a binding transaction, signed last week.

We expect the conclusion by the end of the Second Quarter. This is a very relevant transaction for us. And when you consider how a healthy private equity portfolio progresses, exactly like this, right. So you have some companies that -- some investments that are the 10X investments, in our case Rede D'Or, or (Istapar) are good examples of that, or even some of the listed transactions that we have here in this page.

We have some flat-ish investments. And we have some investments that go under restructuring. And the composition of that create the return of the portfolio. And there is some mismatch in terms of quarter when we sell something, or when we mark down something. But luckily the portfolio will progress in a positive direction. And we're absolutely convinced of that.

And these numbers of Rede D'Or, when you compare the unbooked earnings there, it's relevant, even in the context of the principal investment invested in all companies that we have or we invest. So it's very, very relevant.

And the issue of Sete is getting behind us in terms of exposure, even though the perspectives of the Company progressed quite well in the last 30 days. As you know, the Company's under a stand-still with its creditors, it's a big project. So BRL27 billion were invested there.

We have, as I said, the beginning of the year, about BRL1.1 billion of exposure. And we marked down close to BRL300 million, now we have BRL839 million of exposure. So we will continue to maintain our conservative accounting approach. And we will mark down things, like charge all the costs of carry. And do mark up only dividends, equity pick-ups. And secondary sales.

That's how we booked all the earnings in the past. And how we will continue to manage the portfolio from an accounting perspective. For the future, we expect the banking side of our business to grow more than the merchant bank side.

We already spoke about that in the last quarter. And I think this is a trend, as we also said, we don't see things progressing at the same time. So we agree a lot on that. Now a lot of investments are maturing. So we'll probably do some divestment while we are growing, for example in wealth management with the acquisition of BSI.

But anyway, I will finish here my introduction. And I will hand it Marcelo Kalim, our CFO, that will go in a little bit more detail, business unit by business unit.

Marcelo Kalim {BIO 16142515 <GO>}

Thanks, Andre. Good afternoon, everyone. Thanks for attending this call. If we can go to section 1, talking about the business areas, page seven we have investment bank. This quarter we issued BRL41 million of revenues in investment banking, which is a very low number, a very slow quarter.

And I think this is mainly for one reason. The second half of last year probably given the Brazilian elections, it was a moment that most of the companies waited a little bit to start progressing on business. And this reflected in the First Quarter this year.

Although we were very optimistic with our investment banking pipeline, it did not materialize in the First Quarter. We believe that it's already happening. Not only we are seeing some things happening in the Latin context. But the Carlyle transaction with Rede D'Or portrays that.

So even though we had a very, as I said, slow quarter for this year, we remain very optimistic. And we believe we will be able to maintain the level of revenues that we have been showing in the last couple of years.

Turning to page 8, we have corporate lending, where we had BRL318 million of revenue, our best quarter ever in corporate lending. And here we have a little bit of different explanations. But first, I would like to point out that the broader credit portfolio went down a little bit to BRL49.1 billion, from BRL52.1 billion.

And this is due to our strategy. We have been saying that we are seeing spreads go a little bit up in the region. And we exploited that instead of growing our portfolio. We were able to maintain the same expected revenues, with growing our portfolio a little bit. So I think we were pretty successful in that strategy, maintaining a very good portfolio with higher spreads. And able to generate the same kind of revenue with a little bit smaller portfolio.

The number BRL318 million, it's composed of two main things. One, I think a very healthy portfolio, we didn't have any relevant markdowns in our portfolio like we had last quarter that was related to an (ebb). But also we had 1 times on our NPL portfolio.

Some of those portfolios we acquired in the last 24 months. And they have been performing pretty well. For the next quarters probably we don't expect any significant one-offs on the NPL portfolios, however we believe with this scenario we are seeing that we will be able to sustain around BRL200 million of revenue from this unit that we saw in the last quarters.

Also some updates on (MF), which was as I said, a major markdown last quarter, the chapter 11, for lack of a better translation to English, of (recuperacion judicial poses of MF), has been going along what we planned. And given the marks on our books, we believe this probably will be able to show some positive revenues going forward.

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So also on this area we're very comfortable with the outlook. And just to emphasize with the recent weight of, again, chapter 11 for the lack of better words, of some companies, mainly construction engineering companies related to the Petrobras scandal, we were not affected, or all the effects that should happen in our books have already happened. And we were able to show these kind of revenues. So we do not expect any continuance of this process going forward.

So on page nine we have sales and trading, again an area that showed record revenues, BRL1.1 billion. And two main highlights here. One is positive contribution from all of our desks, which is a pretty satisfying scenario.

As Andre mentioned in his earlier remarks, I think the market conditions have been pretty good for our sales and trading activity, with volatility, with clients being interested, with interest in the region picking up again. So we're really able to exploit those trends in our sales and trading books.

Also I would like to highlight a very strong performance from our commodity desks, especially grains and metals. Of course this is a very good revenue, we are very optimistic. But probably we are going to see the next quarter let's say a reversion to the mean, or reversion to the trend.

But we expect from quarter to quarter sometimes to be able to show let's say outsized revenues which was clearly the case this quarter. And we said we're pretty satisfied with the picture, since all of our trade investments posted positive revenues.

On page 10, we have asset management, where our revenues reached BRL270 million. And here the story is the following. It's a little bit of a decrease from the First Quarter last year, where we had BRL350 million of revenue. But I would say from a qualitative viewpoint, a better result.

Basically all of the revenues this quarter were related to management fees. Basically our global hedge funds, which are the funds that we accrue performances on the First Quarter didn't have performance fees, which was not the case on the First Quarter of last year.

So as I said, this is from a qualitative point, a much better picture. As you can see from our assets under management that reached to BRL215 billion, which is a 15% increase year over year. And of course we do plan to have performance fees all the time. But even when that doesn't happen, we are still able to manage to get this kind of revenue.

We do expect performance fees to get back on track for the rest of the year. So here also we have a very positive outlook. Just one final remark on asset management, which is something that we've been talking about for the last quarter, is the mix of revenues.

We are increasing the revenues with the same kind of assets under management, where we are getting more value-added products. So our equities and hedge funds are getting

more traction. And we are losing a little bit of assets under management on the more passive products. So the average management fee on our portfolio is increasing. So that's why I stated these BRL270 million from a qualitative viewpoint is a very strong number.

Page 11, we have wealth management. And here is a very healthy picture also, one that we would like to show in asset management going forward as well, BRL109 million of revenues, which is a very high number. And BRL87.2 billion of assets under management, which is basically a 28% growth year over year.

Net new money was positive BRL300 million. And by seasonality, usually the First Quarter of this year is the slowest for net new money. And hopefully we can get the same kind of net new money that we saw in the other quarters of last year.

Actually April has been a pretty good number. So probably in the Second Quarter we will be able to show numbers very similar to the ones that we showed last year. And here again also the trends continue to have more value-added products on our portfolio.

On page 12, we have principal investments. And where I mentioned the impairments on Sete Brasil that affected our private equity revenues. We had negative BRL537 million of revenues in the private equity. Part of this was the Sete Brasil impairment. And part of it was basically the cost of capital on our private equity.

Since we didn't have any significant equity pick-up or dividends in this quarter, all of this cost of capital showed a negative revenue for it. The same thing at global markets, although we had a small positive nominal return, it was below our cost of capital. So that's why we show a negative BRL35 million of revenues.

On real estate, we had positive BRL128 million, mainly due to positive contribution from our stake in BR Properties, which went up in price during the quarter. So the number for the quarter was negative BRL444 million.

We turn to section 2 where we have expenses on page 14. And here the picture is that a very stable cost, salaries and benefits. And administrative and other, are pretty much in line where they have been in the last quarter.

The cost-income ratio and comp ratio absolutely under control, 40%, probably the comp ratio a little bit lower than what is going to be for the rest of the year. And also, another point I would like to make here, the income tax rate 27% probably is a little bit higher than what it is going to be for the rest of the year.

Also from a seasonality reason, the First Quarter and the Third Quarter we had higher tax rate than the second and the Fourth Quarter. So we believe that for the next quarter, this rate is going to be lower than the total tax rate for the year is going to be very much in line, which has been in the past couple of years.

On section 3, we have our balance sheet, where total assets reached BRL225 billion. Our cash increased a little bit from BRL9.6 billion to BRL10.8 billion. And here shows our conservative approach since the markets are still in a scenario that requires some caution, we decided to increase more our cash holdings.

The rest of our balance sheet remains pretty much the same. The only highlight that I would make is the coverage ratio, which went up a little bit to 195%. This is due to a decrease in our credit portfolio as we saw before. And the maintenance, or actually a little bit of an increase on our unsecured funding. So our coverage ratio now it's at almost 200% level.

Turning to page 17 we have our unsecured funding base, which grew from BRL68 billion to BRL71 billion, with growth in all the instruments that we use, except for time deposits that were more than compensated for the others. So here also a very healthy picture, we are able to increase our unsecured funding, maintain the costs pretty competitive for our business. And a very diversified basis, also by instrument. And also by client base.

Finally, on page 18, we have our Basel ratio and Value at Risk. The Value at Risk increased from 0.47% to 0.59%, which shows the more activity on our sales and trading desks, which for us I think is a very good sign, because of increased activity reflected on higher revenues. So that's the picture that we always would like to see.

So that's made our Basel ratio decrease from 17.5% to 16.7%. I would like to point out that this is still above our long-term target of 15%, because we we're still preparing for the BSI acquisition. And just an update on BSI, one of the final major hurdles for the acquisition has happened, which is BSI's settlement with the U.S. Department of Justice which happened in April.

So now we are just waiting for the final regulatory approvals. And we expect this to happen in the next couple of weeks. And when that happens, we should expect our Basel ratio to convert dollars 15% on the long term. I think that concludes the presentation. And now we can open for Q&A. Thank you very much.

Questions And Answers

Operator

The floor is now open for questions from investors and analysts. (Operator Instructions) Our first question comes from Jorge Kuri, from Morgan Stanley. Please go ahead with your question.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning, everyone. I have two questions. The first one is on Sete Brasil. If I understand correctly, you're taking a 25% haircut on your investment there to reflect what you think is the new value of the company on an ongoing basis. I think you're making the

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case that you do think that the solution will be found. And that the business will be an ongoing business.

Given that most oil-related plays in Latin America that actually trade in the market are now at a fraction of what they were a year, two years, three years ago, do you think that a 25% haircut you're taking now overestimates the value of that business today? Does this mean that there's a risk that we could see potential haircut independent of whether the business can be an ongoing basis or not? That's my first question.

Second question is on HSBC. And there's obviously all sorts of press articles about BTG being one of the potential candidates for it. You obviously cannot comment on whether or not you are. But just in general, can you walk us through your appetite for increasing the exposure of the Company to retail banking?

You've clearly been showing some interest through the acquisition of Banco Pan. But this would be obviously a much bigger transformation of your balance sheet. And you seem to be happy with the transformation of your business towards a more fee-based business. And this would be probably a move in the opposite direction. Thank you.

A - Andre Esteves {BIO 1939152 <GO>}

Well thank you, Jorge. First related to Sete, your reading of the situation is quite right. So we did 25% haircut on our investment. And our analysis is that this reflect our best understanding of the situation at this moment on a conservative accounting approach.

So it's in reality the situation progressed positively in the last 45 days. But we still don't have a final equation for the balance sheet of Sete. A lot of money has been invested by investors and banks in the form of equity and credit. We don't have any credit exposure to Sete, we just have this BRL1.1 billion equity investment, that we have reduced by close to BRL300 million, now it's around BRL800 million.

The issue about the industry doesn't apply in reality to Sete, because Sete at the end of the day is the project finance. So it's basically you have a contract to Petrobras. And you have a contract with ship yards. And you basically will carry the rigs to Petrobras under this arrangement. And with a lot of details around that.

But it's a project finance. So it's much more putting the finance in place, than the market value of the rigs, or the perspectives that Sete has. And it's supposed to have just one client and one asset. So it's a very small management team that basically monitors the construction of the rigs. And structure the finance of the company.

So in this sense it's a little bit different. You should look at Sete as a project finance. It was basically a special purpose co-created to carry the rigs outside the balance sheet of Petrobras, that was the Petrobras and BNDES intention when they came to the banks and to the investors to raise money for this project.

So that was the idea. And as we said before, we think it's much less expensive concluding the project than finishing the project. So that's why we think generally stakeholders will move in the direction of rational approach.

But given the pitfalls and the challenge, every stakeholder will probably need to concede a little bit in order to find a new arrangement or new solution. So we consider this 25% what is reasonable from a conservative base, the cost for the shareholders of the new structure. That's more or less, maybe oversimplifying a little bit. But our view of the case.

Regarding your second question, we cannot comment on specifics. But we're always ready to analyze opportunities, especially in our core market here in Brazil. But we are very glad to honor what we are and what the platform we have. So for us, it's a very high hurdle, or high bar, moving from what we are to something different. So again, we are obliged to analyze situations in our market. But we like very much what we are.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Thank you, Andre.

A - Andre Esteves {BIO 1939152 <GO>}

Thank you, Jorge.

Operator

(Operator Instructions) Ladies and gentlemen, at this time I'm showing no additional questions. I'd like to turn the conference call back over to Mr. Andre Esteves for closing remarks. Thank you.

A - Andre Esteves {BIO 1939152 <GO>}

Guys, once again, thank you very much for being with us. And being close to the developments of our Company. Thank you very much. And have a good day. Thank you. Bye-bye.

Operator

Thank you. This concludes today's presentation. You may now disconnect your telephone lines. Please have a nice day.

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