Q3 2016 Earnings Call

Company Participants

- Joao Marcello Dantas Leite, Executive Officer, Chief Financial Officer and Investor Relations Officer
- Roberto Balls Sallouti, Co-Chief Executive Officer

Other Participants

- Carlos Macedo, Analyst

Presentation

Operator

Good morning and welcome to the Third Quarter of 2016 Results Conference Call of BTG Pactual. With us here today, we have Roberto Sallouti, Joao 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 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 November 9th through November 15th.

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 depends 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 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. Thank you everyone for joining. The end of the third quarter marks the end of the strategic repositioning, which started at the end of last year for us and this is signaled by the distribution of Engelhart Commodities, our old commodities unit and the sale of BSI and the consequential deconsolidation of these two units in our balance sheet. This leaves us operating at a very high level of capital, liquidity with very low leverage and focus on our core activities.

We're actually quite satisfied with the operational performance of our core activities, and the best way to visualize this is by looking at the return on equity of BTG Pactual, ex-ECTP and ex-BSI. And for the first -- for the third quarter, this return on equity is 20% with a net income of BRL921 million and BRL0.99 per unit. On a consolidated basis, that means BTG Pactual, including BSI and ECTP, the numbers are a bit lower, especially because of the ECTP results.

For the third quarter on a consolidated basis that gives us revenues of BRL1.5 billion and BRL661 million of net income. We actually think that these numbers do not represent what is the true value creation for BBTG11 shareholders and we have a page, a couple of slides in of about three slides, that we will show this in the variation of the book value of BBTG11.

The quarter also marks the end of our labor and administrative cost reduction and the end of our deleveraging efforts, which also began at the end of last year. We finished the quarter with roughly BRL128 billion of assets, which is a leverage of about six times our equity and a very conservative capital ratio of 20.1% and also throughout the third quarter, we had a lower VaR than in the last quarters at 57 bps.

If you turn to the next page, which is page four, you can see the results of our nine-month year-to-date on a consolidated basis. It has -- we have revenues of roughly BRL7.7 billion and a net income of BRL2.7 billion, giving us a year-to-date return on equity of 15.4%, which is actually, roughly the same for BTG Pactual on a stand-alone basis.

For these nine months, we have also maintained the main ratios in line what has been our recent past and looking at BTG Pactual's stand-alone, this means the cost to income ratio of 45%, a compensation ratio of 20% and there's a net margin ratio of 47%. You'll also notice that in the nine months -- in the past nine months, our shareholder equity increased by 8% to BRL23.9 billion, this already including the interest on capital that was announced in the first half of the year and already distributed to shareholders.

If you move on to page five of the presentation, you will notice a new slide, which we created to show the value creation for BBTG11 shareholders. Since there have been many moving parts throughout the last quarters, most importantly the ECTP distribution and the buyback program, which we have had in place since the end of last year, much of the results -- the resulting value creation for shareholders is not flowing through P&L.

This is why we decided to show this slide. And if you look on the graph to the left, you will see that from the second quarter to the third quarter, we had an annualized rate of change in the book value of the BBTG11 unit of 24%. This is in part due to the buyback program and in part due to the ECTP distribution. We think this is probably the best way to show, since we had a lot of moving parts in the last quarters, what was the value creation to BBTG11 shareholders. And it's also important to mention that the ECTP results did not fully impact the book value of BBTG11, because the ratio of this distribution of the old commodities unit that -- and what would be in the BTG bank was defined at the end of Q1.

So if you then turn to page six, we show the business unit breakdown by revenues and a few highlights to point out here is, the very strong performance by our investment banking unit, even though the market is still picking up and the pipeline we currently have leaves us quite optimistic with this investment banking activity for the future. You will also notice the strong performance by corporate lending. This is especially due to the performance of our NPL portfolio and the recuperation of the credits, which happened in that unit. We had in sales and trading, a subpar performance especially because of the commodities business. However, when you strip that out as can be seen here in the graph, this becomes mainly in line with the past.

And finally, it's very important to comment the Asset Management and Wealth Management results, which while they were in line with the recent past, the positive news is that the net new money at the margin has been very positive in both Wealth Management and Asset Management and not only that, but the robust pipeline we have, and the very good performance that we've been having in our funds, in the recent history also leave us very optimistic for these two business units for the near-term future.

With that, I pass over the word to Dantas, who will give a bit more of details on each of the business units.

Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Thank you, Roberto. So, as you know we will make some comments on the performance of the business areas, in which I will go quickly, and then following that we'll make comments on the balance sheet and the KPIs, which I think are the biggest highlight for the quarter.

So moving to page eight, we start with investment banking and you'll see that revenues reached BRL110 million in the quarter, going from BRL80 million in the second quarter and BRL62 million in the first quarter. The revenue growth here reflects a strong performance of our M&A team and we have been very active in this market recently.

ECM and DCM activity levels in LatAm are gradually picking up with the progress of some important structural reforms that are happening across the region. And we expect that the revenue contribution from ECM and DCM can be -- can increase in the near future. And I think another highlight is that our investment banking teams continue to be the main player in the Latin America markets, across the region we continue to be leaders.

Moving onto page nine, we have corporate lending. So here the revenues reached BRL218 million in the quarter, which is a revenue level very much in line with the recent quarters, despite the fact that the corporate lending portfolio has been reducing as you can see in the right hand chart. The reason for that is twofold. First, revenues in the quarter and during the year benefited from growing spreads, the gross spread have been growing as a trend in the last quarters in LatAm, especially in Brazil. And also, we have answered this more recent cycle of credit in Brazil with, I would say, very adequate levels of provisions. So while you see other banks, especially in Brazil adjusting their portfolios to mark the adequate levels of provisions, we have had increased our provisions during 2014 and are now in a very comfortable situation. Also, I would mention that this shows the resilience and the quality of the portfolio, which remains the same even after the sales that were performed during December and January this year.

Moving to page 10, we have sales and trading, where we're showing revenues here of our sales and trading division, and separately of the commodities division that -- as Roberto mentioned, was spun-off, was distributed during the month of October. The first highlight here is the lower level of risk taking. As we saw before, our average VaR went from 0.96% of average equity during the second quarter to 0.57% during this quarter. This comes mainly from lower risk taking in rates and in commodities products, especially in commodities the negative contribution of ECTP can be explained since after two very strong performance quarters, the first quarter and second quarter, the third quarter presented tougher market conditions and a much higher volatility.

ECTP have been adjusted positions and now continues its staff of establishing and consolidating its business platform in which we continue to trust very much and we look forward to continued good performance. Also during the quarter, we had good performance in our equities in FX there, and lower revenue contribution from rates and energy in Brazil.

Flipping to page 11, now we have asset management, where you'll see revenues in a level of BRL140 million, pretty much in line with the second quarter. Typically, in the second and third quarter we have predominantly revenues from management fees, very low recognition of performance fees during these two quarters. Also, you'll see that on the right-hand chart, you'll see the level of AuM. What I would highlight here is three important points. First, we have to analyze the AuMs and the net new money, excluding the impact from redemptions in fund services. Fund services mandate represent basically a custody and fund administration and we had -- as we mentioned before in previous quarters, we had many requests for transferences, processed during the first quarter, mainly during the first quarter and these are being executed as we speak. It takes some time, because it requires the new service provider to set up its facilities et cetera for the services.

And if we exclude the impact from those funds out, the net new money in the quarter for Asset Management was actually positive in all product classes, so this is a very important aspect. During the quarter we see that clients are coming back, mandates are being very well executed, our flagship funds, our market leaders in performance both in hedge fund and equities categories across LatAm, especially in Brazil and also the net new money that comes in -- it comes in at a higher -- a much higher ROA. So, the running rate for our ROA, despite the negative net new money in the quarter, didn't actually change, it remained stable.

Moving to page 12, in Wealth Management, we have more of the same performance that we saw in Asset Management. But here, we don't have these typical custody and administration mandates, so you'll see that the net new money is actually positive and it's positive also across products and asset classes.

So even though we have the reduction in Wealth under Management in the beginning of the period, it starts to come back. I would say that not only revenues are stable in terms of management fees, they -- we saw a little bit of less market activity and a one-off credit provision during the quarter, which impacted the revenues for BTG Pactual standalone. I think it's important to note that going forward, we will not report BSI revenues as we deconsolidated and sold our Participation. So it's important to look at the BTG Pactual standalone revenues, which went from BRL82 million to BRL70 million in the quarter. But again, the biggest impact in the reduction is a one-off credit provision.

Moving to page 13, principal investments. Basically, here we show the revenues of the three business lines separately. In global markets, we had flat performance in a tougher quarter with more volatility and the negative revenue of BRL27 million is basically the cost of funding that we allocate to the positions. In Merchant Banking, we have our results benefiting from the share of profits on our invested companies and also from the appreciation on some of the listed positions in the portfolio. In real estate, basically this is the cost of funding we had no events during the quarter.

Now we move to page 15, where we have the expenses and KPIs. I think the best way to look at expenses is also excluding the impacts of BSI and naturally without BSI, going forward it's going to be much easier to understand our efficiency ratios.

At the bottom chart on the right hand side on the column nine months 2016, you'll see our cost-income ratio and compensation ratio, so excluding BSI during the year we had 46% cost to income ratio and 27% compensation ratio. It's important to note first that since we implemented all the cost reduction initiatives during the first and second quarter, we are now in the third quarter in full fruition of the benefits from that.

Also our CIR of 46% shows I think very well the resilience and flexibility of our business model. As you know. we can operate the bank with higher or lower revenues -- levels of revenues and maintain efficiency ratios and cost to income ratio in very adequate levels, since the largest cost in our cost base is the variable comp bonus and that is linked to the bottom line directly. So this is the -- these are the ratios of efficiency in which we expect to operate going forward.

Moving onto page 17, we have the balance sheet analysis and as I said before, I think this is the most interesting aspect of our performance in the quarter. I think this chart on page 17 shows very well that basically we have delivered on what we have promised. We said that we were going to deleverage the balance sheet, the leverage is now, as Roberto mentioned, at six times assets to equity coming down from an average of 12 times in the recent past. Our liquidity pool is 50% higher than what we held before November last year. And the short-term funding, which is the other side of the liquidity coverage is almost zero. So, we have increased the tenure of our funding, reduced almost entirely the short-term components of the funding base and increased our liquidity pool 50%. Also, we have a capitalization ratio above 20%, which is a very strong foundation of the balance sheet. This is the foundation in which we plan to maintain ourselves in our balance sheet going forward. More important, this is how we will run our balance sheet to support our core activities. I think as we said during the quarter, we have fully repaid the assistance line from FGC, which was a very important assistance line provided in the very end of last year and the full stabilization is completed, so the line is repaid entirely.

We have concluded and liquidated the sale of BSI to EFG, the distribution and deconsolidation of commodities. We concluded the implementation of the cost reductions. We distributed today the previously announced dividends of the first half, had an upgrade in our ratings, so all that is reflected, we believe very well, in this chart where we see where our balance sheet is. And the asset quality remains strong as ever, after the sales and deleveraging efforts, we keep very good quality of our assets in our balance sheet.

Moving to page 18, we have excluded BSI figures here to understand better the composition of the portfolio of the credit -- of the broader credit portfolio. And here, you see the 28.9% is the level of credit, which we believe is a good foundation, since it's well-funded by our liabilities by about 45% of this is off balance sheet and 55% is on balance sheet credit.

Next page, page 19 shows the unsecured funding, which was the other side of the balance sheet of core debt. We are also showing the figures already without BSI. We believe very much that the funding base is adequate to the new structure of the balance sheet. It is a funding base with a longer average maturity well diversified. We continue to have excellent access to all counterparties in all segments.

And finally, we have the slide on page 20, which is the Basel ratio and VaR, and as we've said, Basel ratio has reached 20.1% after the consolidation of BSI and ECTP and this is the level in which we will maintain the balance sheet going forward and the Daily Average VaR as we said, has reduced from 96 bps to 57 bps.

With that, we conclude our analysis and the presentation and we 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) The first question comes from Carlos Macedo with Goldman Sachs. Please go ahead.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thanks. Good afternoon, gentlemen. I have a question more related to what to expect going forward. I mean you talked a lot about this 20% ROE is very solid. A couple of questions -- one more technical question, when you get to that 20%, what tax rate do you assume and what should we assume going forward, now the operations are going to be much more centered in Brazil?

Number two, 20% capital ratio was very strong, 12.3% Tier 1 is particularly strong, you're not going to do apparently much more lending that you do now at least you resized the portfolio. Is there anything -- is that excess capital what level of capital you hope to run the bank with on a Tier 1 basis? Thanks.

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

Thank you, Macedo. Thank you for your question. As you said, clearly, we have a very stronger liquid balance sheet right now. Clearly, it is more conservative than probably it will be in two or three years' time. However, for the next few quarters we think in order for us to speed up of having our client franchises back to the level that they were at the end of last year, we want to keep our balance sheet conservative for the short-term. So what you can probably expect is a very gradual decline over this capital ratio, as we allocate capital on a very conservative basis in the next few quarters. And we agree with you, it's clearly inefficient. But we think that this is the best thing for us to recover the client franchises to the level they were at the end of last year.

Having said that, this probably means that you will also see a higher return on equity as we allocate this capital in the next few quarters, even though it's too early for us to start giving any guidance right now on return on equity. We have just concluded the strategic repositioning, we are very confident about the future prospects of the business. But as I said, we still want to be conservative in the allocation of capital -- of those excess capital we currently have.

Q - Carlos Macedo {BIO 15158925 <GO>}

Great. With respect to the tax rate then I mean, with being more Brazil centric do you move more to the high 30s where Brazil is, or do you think you can still keep the profile of a little bit lower given the principal investment base that you have?

A - Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Carlos, Dantas here. The profile was always lower than the nominal rate in Brazil, as you know we have the deductibility of interest on capital and we have a mix of businesses that are not only ran at the Brazilian corporate tax rate. So you can always expect us to deliver tax rate in line with our past, which is the nominal rate that typically apply to our mix of businesses. In the current quarter, the tax rate was slightly lower, a bit lower as you saw. It's of course, coming from the revenue mix and going forward it stabilizes in levels that we think are in line with the recent past. No changes there.

Q - Carlos Macedo {BIO 15158925 <GO>}

So, basically the revenue mix changing a bit from the sale of BSI and the spin-off of Engelhart, you should see that reflected in the tax, the effective tax rate that you'll report every quarter?

A - Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Yeah, remember that in Brazil, these components of income from BSI and ECTP were consolidated. So we always look at a full tax impact on the Brazilian consolidated basis, right. So we pay the regular corporate tax in Switzerland, the regular corporate tax in all the countries in which we operate in commodities. Now we consolidating Brazil, Brazil has a higher corporate rate than Europe, typically in line with Americas, both North America and South America, and that is the rate that we have been running the business.

No, it's not 45% it's lower than that, given the impact of JCP and given the mix of revenues at 34% corporate tax and revenues at 45% corporate tax. That's the idea. It doesn't change and is based on that assumption that we look forward in terms of our expected returns.

Q - Carlos Macedo {BIO 15158925 <GO>}

Perfect. Thank you. Thank you, Dantas.

Operator

(Operator Instructions) Showing no further questions, that brings us to the end of the question-and-answer session. I will now return the floor to Mr. Roberto Sallouti for his closing remarks.

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

Thank you all for joining the call. Once again, we're very satisfied to have ended our strategic repositioning, we're very satisfied with a very strong and liquid balance sheet we have and we're looking forward to being here next quarter, already talking about the business back to growth mode, as we allocate this excess capital that we currently have. Thank you very much and have a good afternoon.

Operator

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