Q1 2014 Earnings Call

Company Participants

- Andre Santos Esteves, Chief Executive Officer
- Marcelo Kalim, Chief Financial Officer

Other Participants

- Carlos Macedo, Analyst
- Daniel Abut, Analyst
- Tito Labarta, Analyst

Presentation

Operator

Good day and welcome to the First Quarter of 2014 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 on -- substantially on changes in market conditions, government regulations, competitive pressures, the performance of the Brazilian economy and the industry among other factors and risks disclose in BTG Pactual's file 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. Mr. Esteves, please go ahead sir.

Andre Santos Esteves {BIO 1939152 <GO>}

Good afternoon. Thank you very much to you all for being in our call. Well, we announced results of our first quarter of 2014 of BRL832 million and we are glad with these results. Net income of BRL1.7 billion. And a return on equity above 20%, 20.2% return on average equity, in line to what we have been telling you in our previous conversations. We continue to believe that we can deliver returns above 20% in the next years, in 2014 and in the next years. These results were achieved keeping expenses under control. So, very good cost income of 38%, which is a relevant ratio for our industry including compensation ratio at 23% for the quarter. Coverage ratio was slightly (technical difficulty) just the distribution of fee income among the quarter. So, we don't expect anything different from our around 200% ratio for the year.

Total assets of 194 billion it's slightly above the end of last year. And also Basel index little bit above 17%, which is in line between quarters. Also, the VaR was 0.54% compared to our equity which is in line to the last quarter. And, which means that the market risk reduction that we promoted more on less one year ago, we kept the same level of market exposure.

I think what is relevant news in this quarter. First, is the fifth quarter of earnings growth. So, it's the fifth quarter in a row that we continue to grow earnings, which is good news. And once (technical difficulty) quarter is BRL16.9 billion. (Technical difficulty) the results that we announced.

So, basically what will impact our shareholders' equity is exclusively our earnings and dividend distribution. On a qualitative note, basically all of the business performed quite well, independent of a more challenging environment. And what we showed once more in this quarter we'll read the market language is that our capability of generating offer in the different franchise is there.

So, it was for us, very good qualitative results. It was also the first time that we had our full cylinders working in the commodity division as we recently created more or less a loans of 2013. So -- and basically all the business units' performance, as I said, been a little bit challenging scenario for capital markets in Brazil and the Latin America. Our Latin America integration continue to progress quite well. So we are performing our budgets in all the countries that we have operations outside Brazil. Also our international footprint continues to grow and continues to contribute on the relevant way for our earnings.

I will hand over to our CFO, Marcelo Kalim to go into more details of each business units and then I'll be ready to answer your questions at the end of our presentation.

Marcelo Kalim {BIO 16142515 <GO>}

Thanks Andre. Good morning and good afternoon everyone. For those of you who are following the presentation, we can start on page 6 where we have total revenues and the breakdown by our business units. And two point here, the first one I would like to mention is a little change in the way we show the number for Banco Pan. I am eager to show the results, our stake in Banco Pan, our stake in the (inaudible) net of our funding cost because in this quarter we are going to start showing the -- our share in the profit of

Banco Pan on a nominal basis without the funding cost. And this is a comment or suggestion they received for (technical difficulty) to be more a straight forward translation between the earnings in Banco Pan and our earnings release.

First starting this quarter this is a nominal value. (inaudible) net of earning cost which shows just the aggregated value of each business unit in terms of revenue. And to continue on this picture, first of all we are very pleased with the distribution of revenue, our mix of business areas. And the highlight here is the revenues for sales and trading. It's by far the best quarter that we have since the operating company and we are extremely pleased with the outcome of this unit and our new platforms, specifically commodities and we are going to talk a little bit more about that when we go into the business areas. Flipping pages on page seven we have our investment banking division, and here the story again is a diversification of profit that we have.

Our revenue reached BRL70 million which is higher than last quarter, which was 50, but a little bit lower than the first quarter of 2013. And here I think it's (inaudible) because the equities market in general was a bit quiet this first quarter and we were able to have good revenue streams from other area specifically M&A. We still remain very optimistic for the year. Our pipeline of deals and transactions announced and the ones that we are not announced and that we expect to conclude this year makes us pretty confident that we'll be able to continue in a very good pace of revenues in this type of the business.

On page 8, we have our corporate lending unit and revenue reached BRL197 million, a little bit above last quarter which were 187 and little bit smaller than 210 million, maybe we reached in fourth quarter of 2013. If you remember in the first quarter of 2013, we had a one-off event which (inaudible). But you can see that without these one-off event that we are slowly increasing the structure of our revenues in corporate lending. And this is in line with the increase of our broader credit portfolio which reached BRL39.4 billion for the quarter.

We do expect to see our broader credit portfolio to grow a little bit this year not to be as stable as it was last year. And this -- and almost the stability from quarter to quarter here really doesn't reflect the growth because on an average basis, probably our first quarter was a little bit higher the credit portfolio than in the last quarter.

So we do expect this trend to continue and to continue to increase our credit portfolio throughout the year. On page 9, we have our sales and trading unit, with revenues of BRL874 million, as I mentioned our best quarter in sales and trading so far. And the story here is two-fold. One, basically all the trade invest performed extremely well, which is a very good, as Andre mentioned in a challenging scenario, but given the client activity and our understanding of the dynamics enable us to really perform extremely well.

But, I think the most important news here is that our global commodities platform started to contribute in a significant way for the first quarter. We have been mentioning throughout the last 18 months more or less that we were building these units and it started to show some revenues late last year. And we would expect that this year would be the first year that these unit of sales and trading start contribute to revenues.

And actually it happened -- starts to happen in the first quarter. And this gives -- this gives us a lot of confidence in business practices. We already started to putting together commodity sales and trading business together with our, let's say, financial sales and trading business, would be a very good proposition for clients.

And actually showed that we were right on that thinking and also these resulted a lot of happiness that we were able to implement the strategy that we though. So, either were not only a very good quarter from a revenue standpoint, but also from a strategic standpoint to show that at least on our view, we were correct on implementing this global commodities platform. On page 10 we have our asset management business, and I would like to point out here, the significant growth from the -- not from quarter to quarter, very specifically on a yearly basis.

Our revenues which were BRL350 million, smaller than the last quarter, However, as you know, by the end of the year we book the accrued performance fees of (inaudible) fund. So on a seasonal basis, the last quarter, the year tends to be much higher than the other. So I think the better comparison would be with the first quarter of 2013, which had BRL253 million of revenue. So that is significant growth.

And this is explained basically by a little bit of higher assets under management but that's just a very small part of the picture, because for the year our assets under management are more or less stable. However, we have a much better mix of products in terms of revenues. And this is because we basically are increasing our more value added products, specifically our global hedge fund business, our alternative investment business, private equity, real estate, infrastructure and also our equities franchise.

So basically we are, let's say, changing from low value added products to more value-added products. So we do believe that the asset management business is on very strong trend in terms of revenues even though assets under management are somewhat stable.

On page 11, we have our wealth management business. We've had BRL93 million of revenue, a little bit more than last quarter and a little bit more than the first quarter of 2013. Assets under management reached BRL68.2 billion with 600 million of net new money. And the story here is that we are starting to see a little bit more of a client activity in the first quarter of this year. We had somewhat less active clients throughout the end of last year and now we are seeing a trend that the activity is picking up which lead us to be more optimistic about these units not only in the revenue side but also on the assets under management. So we expect that this trend continues to show a good (inaudible).

On page 12 we have our principal investment unit. And here it's a mixed backlog, put it like that because our global market unit had a positive revenue with BRL84 million. Our merchant bank revenues were slight, let's say stable with negative BRL35 million. And our loss on our real estate portfolio of BRL163 million. And the loss in real estate was directly linked to our stake in BR Properties which devaluated throughout the quarter. The total revenue of the unit growth BRL150 million negative.

And although it's a negative, the results we are simply confident in the strategy and confident in the results of the year. As we can see from the -- through this quarters with by nature more volatile and even though we can have a negative quarter every now and then we believe that some of the quarters throughout the year can be very positive. And, as I said, we are extremely confident that these areas can deliver very good results as we go along 2014.

Now I move to section two where we talk about expenses and on page 14 we have the numbers for expenses. And I think here I would like to highlight the total operating expenses for the quarter BRL647 million, smaller than last quarter expenses, but here there is some seasonality as well. But, more importantly smaller than the first quarter of 2013 and which reached 663. And the translation of that is a very low cost to income ratio of 38%. And I would like to emphasize that this is I think one of the very important characteristics of our model.

We focus on cost control and when we were able to combine our tight cost structure with good revenues, we plan to produce very interesting cost to income ratio and compensation ratio which is exactly what happened this year 38% of cost to income ratio is much more than the full year last year. And we do expect to continue on that front for every year. So in that scenario, I think we are really optimistic on being able to deliver very good metrics.

On section three, we have our balance sheet. On page 16 we have our assets and liabilities. Total balance sheet side reached BRL193.9 billion, an increase over last quarter. But the overall shape of the balance sheet continues this time [ph]. And I would like to point out by (inaudible), which is stable against the last quarter which was 182. So this a very good sign that we are able to continue to grow our business with the same kind of funding that we had before. And also to point out the liquid assets 14.2 billion, totally covered by our own net asset, 16.9. On page 17 we have our unsecured funding base which grew to BRL55.7 billion, our highest number so far. And here you see the same story, the growth from the previous quarter and exactly the same shape. This quarter we were able to grow basically all the line where we fund ourselves which enable us to fund ourselves in a very cost efficient base. And we do believe this is (inaudible) of our mutual fund.

Finally on page 18 we have our Basel ratio and VaR equity. And we have mentioned our VaR equity 0.54%, very stable compared to the last quarters and much smaller than we were used to run in the end of (inaudible). And Basel ratio of 17.1% also is stable, a little bit smaller but stable regarding the other quarters which shows that we still have some room to grow our activity. Basically that's the presentation, now, I think we can open to questions and answers. Thank you.

Questions And Answers

Operator

And thank you, sir. The floor is now open for questions from investors and analysts. (Operator Instructions). The first question we have comes from Carlos Macedo of Goldman Sachs. Please go ahead.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good afternoon gentlemen, congrats on the, on the solid results. A couple of questions, first on your sales and trading results, very strong in the quarter, as mentioned, the commodities that's helping. The question is now that the commodities that appears to be fully operational, should this be the new base for sales and trading, what should we consider to be a new base, given that you have a new desk that is contributing to that revenue line? Should we expect it to have -- of course all the other desks also contributed this quarter, but what should we expect going forward in terms of a new baseline for sales and trading?

Second question on the, on the private equity merchant banking, real estate side, so your funds now are 3 or 4 years old, a little bit more, maybe 5 years old, when will we start getting into that divestment phase? I know it's not the best year maybe to divest from assets in Brazil, but do you have an outlook for when this divestment phase might start, so that we can get the realization in some of these investments that you made a few years ago? Thanks.

A - Andre Santos Esteves {BIO 1939152 <GO>}

Well, thank you very much, Carlos, for the questions. And yes, as Kalim mentioned during the sales and trade presentation, commodities were part of this result. But it's important that basically all the business units inside sales and trading performed quite well. So it's up in the -- and even though that the -- basically the market didn't improve a lot in Brazil, but these positive flows of funding in all the asset classes, fixed income assets FDI contributed a lot with these opportunities.

In the implementation of commodity, you should expect on a ongoing basis that the commodity is a relevant piece of sales and trading like the other pieces, not bigger and not smaller. It was I would say a good quarter but definitively over a different basis. As the nature of the business, the revenue vary a little bit from quarter to quarter.

It's -- I would say that the average of last year plus another relevant business unit is the new pattern or the new standard for 2014. We don't forecast or provide guidance other than our continued view of delivery for new shareholders. Return on equity above 20% not only this year but the next years as long as we can see.

Regarding specifically the principal investment unit, or the long-term private equity of state funds. Our private equity venture is a little bit shorter than what you mention, right. We are fully invested. But still relatively recent. So it's the fourth quarter has an average date of two years. So it's relatively new. Of course capital markets are not in the bad shape. So, we should wait until the right moment and meanwhile, manage the companies that we invested or monitor the companies that we invest in, but it will behave as a natural private equity portfolio, so there will be divestments in the next couple of years.

Regarding real estate, it's important to notice that our real estate funds, they are evergreen funds. So, we don't need to divest. We'll keep them forever. It's just the BT Fund, the corporate fund, which is the largest that we have and the largest in the market, it's evergreen, which means that we don't have a date to deliver back, so it's a closer (inaudible) fund.

So shareholders basically can sell their stock in the market or their quotas in the market. But it's for ever a fund and that we don't see any divestment, it's the opposite. The fund has a relevant amount of cash and the managers are waiting good moment for acquisitions. So probably what you will see in the next 12 months is additional real estate acquisitions from our chit funds which is different from our equity participation in (inaudible) profits, which is I would say our principal investment, collective investment.

And in a certain moment of time you will see a divestment of that or via sale or eventually via dividend (technical difficulty).

A - Marcelo Kalim {BIO 16142515 <GO>}

I just want to point out on the sales and trading question, we always said that we will be looking for growth on our sales and trading division through expansion of the product line in the case commodities uses geographical expansion. I think we have been able to implement both in the last 12 or 24 months. So in that scenario we'll do exactly what Andre mentioned.

If you look at our sales and trading business, our moving average, we are believing the growth on these moving average for both these revenue for the quarter I think is a very good one. But if you look at on a more stable basis, probably we are in a higher base today than we were in the previous quarter. So I think that's the extent of the business. We have expanded both geographically and in terms of products that we offer in sales and trading.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thank you, Kalim, thank you Andre. Just one follow-up question, then I think following up on what Andre said that the commodities business has an opportunity of being as relevant as the other businesses within the sales and trading desk, would that be a fair assessment?

A - Marcelo Kalim {BIO 16142515 <GO>}

Yes, if you can see that they are the business as equity of fixed income and effects we have commodities as relevant as the other three business.

A - Andre Santos Esteves {BIO 1939152 <GO>}

As Kalim said, on a normalized basis, like it grew in the right quarter, and the quarter is the orders arrive. But the objective here is, as committed to you guys that we continue to develop the business to different asset classes or geographies that we think as synergic to the existing one (technical difficulty) anything very different. But I would still -- we move to areas where we think we have a big culture, the core competitiveness and we have secured that we can pay a form on a long-term basis and gradually this is moving -- average is moving up and up. So that's the idea and the view.

Q - Carlos Macedo {BIO 15158925 <GO>}

Perfect. Thank you so much.

A - Andre Santos Esteves {BIO 1939152 <GO>}

Thank you Carl.

Operator

Next, we have Daniel Abut of Citi.

Q - Daniel Abut {BIO 1505546 <GO>}

Good morning. A couple of questions. First on the principal investment line and second on growth. On principal investment, I wanted to put together two statements you made. One, we saw the contribution of your global market. It was positive, but on the low side because of the challenging environment in emerging market.

And, then you also said in a different part of the presentation that your BILR has remained pretty much at the same level as it was in the prior quarter, i.e. relatively low levels of risk taken. When we took at this -- at the future, i.e. the rest of 2014, will you start to see a position to move the needle in terms of risk whether it's in emerging market or developed market so that global market could start to have better higher contribution? Or it's still proven to be on the mortgage covered side, so the contribution that we saw this quarter in global market is more or less what we can expect to see.

And second and fourth, if I look at your cost income ratio you correctly said 88% this quarter is significantly below what you did last year for (inaudible). But, I also look at the compensation ratio, which was on the loan side, as it was in the first quarter of last year tend to move to a bit higher levels in the rest of the year closer to 34%, 35%.

So, we have to say that this 38% may be the low point of the year. And then for the year to come your cost income is likely to be more somewhere in the low 40s?

A - Andre Santos Esteves {BIO 1939152 <GO>}

Okay. Well, thank you, Daniel. I will answer the first question. And Kalim will talk about the expense side. On the VaR or market risk, your testament is right. We are more or less working with different levels of risk of the recent quarters of last year. And we don't think them to change, markets improved a little bit, not only Brazil but throughout emerging markets. So, even if we develop that market, but we still secure about delivery what we intend to deliver in terms of return on equity with this level of risk. So, at this stage, we feel comfortable to where we are. And important to note is that the principal investment is not the only area that consumed VaR right, it's on the Brazilian rules, you have different sources of VaR consumption.

And our sales and trading also consumed part of that by the simple fact that you have secured on your books or your market maybe in different sectors of the market. But having said that, we don't intend to change that (technical difficulty) we have right now.

So we are a little bit, I would say more on the conservative side which doesn't restrict us to grow our corporate lending book and doesn't restrict us to continue to provide market making activity for our clients. And didn't restrict us to create the new unit of commodity to promote the Latin America market integration that we did.

So, the results on this area is kindly emphasized on the last question. You are very good not only in the first quarter but they were already good on the last quarter of last year. So, the -- more or less the risk pattern will be kept where we are. But, it will not change our view in terms of year-end results, our forecast on the near term. Kalim.

A - Marcelo Kalim {BIO 16142515 <GO>}

Regarding the cost and the cost income or the comp ratio. A couple of comments, first I think it's pretty similar to the first quarter of 2013 and this is the reconciliation of our model, right. If you are able to generate more revenues from the same quarter, little bit lower cost, the cost income will fall by definition.

And the comp ratio also will be low. So, trying to answer the question, if we do expect that for the year, I believe we could then sustain the lack of revenue that we have been in the first -- that we had in the first quarter. More likely than not to be able to sustain this cost to income and this comp ratio.

So, probably it will be lower than 2013. And again, this is a direct reflection of our model. And also, if you look at the mix of revenue, things we do not (inaudible) by definition having more interest and nor that we take nominally last one which helps to bring down the comp ratio. So, this was measured by direct translation of the dynamics that we use. And we don't expect any significant change on that during the year.

Q - Daniel Abut {BIO 1505546 <GO>}

Thank you Andre, very useful.

Operator

Next we have Tito Labarta of Deutsche Bank.

Q - Tito Labarta {BIO 20837559 <GO>}

Hi, good afternoon. Thank you for the call. I have a couple of questions. Also on -- first on the investment banking align, we did see a rebound compared to the fourth quarter. You also mentioned you do see a nice pipeline there going forward. So I just want to get a sense on how you see this line evolving going forward as what we saw in the first quarter sort of sustainable or if you can maybe just give a little bit more color on that.

And then second question, a follow-up on costs. We did see the salaries and benefits increase quite a bit in the quarter and you mentioned maybe this is an increase in employees. I just want to get a sense on how you see this evolving in terms of do you expect continue to hire a significant number of employees, how you see that evolving for the rest of the year as well? Thank you.

A - Andre Santos Esteves {BIO 1939152 <GO>}

Well, thanks very much Tito. Well, the results of the investment bank as Kalim said, we are glad that we could deliver even in a relatively weak capital markets environment, a higher result in the first quarter than the last quarter of last year.

But more important than that is our optimistic view for the whole 2014. And just repeating what was said, we feel comfortable that we will deliver what we expected in terms of investment bank revenues in 2014, even with the natural uncertainties of World Cup, election year, a little bit of pessimism regarding emerging markets.

So, we don't have a lot of IPOs happening in Brazilian market, but as we all told you guys our capability of generating revenue is not only linked to capital markets activity. I think the offer produced by the BTG Pactual franchise is significant and (inaudible) that is a good proof of that. So, as I said, they announced deals of last week, this week in the pipeline. They give us comfort that we will deliver good results the next quarters during this year. And the quality and the leadership of the franchise also make us comfortable in keeping this view for the next year. And we are talking not only about Brazil, we're talking about Brazil and the whole Latin America or Latin America linked investment bank products or transactions. More specifically, regarding cost and salaries and benefits so you asked there was an increase from the beginning of last year to this year which reflects basically the new investments of the group in terms of -- still Latin America integration, but we opened the Mexican market.

And the implementation of commodity grouping side sales and trading. So, and some additional or regional offices expansion in Brazil that go throughout all the business areas. So, these were the key drivers of this increasing headcount. What we should expect for the next 12 months is probably still some increase, but on a much lower fashion than what we saw in the last 12 months.

So, we will not open any new regional office this year. We already are present in Latin America, and most of the commodity investment was done. So, probably planning some natural increase because the business expands, but I don't see a relevant move as we saw in the last 12 months.

Q - Tito Labarta {BIO 20837559 <GO>}

Thank you. It's very helpful. Thank you very much.

A - Andre Santos Esteves {BIO 1939152 <GO>}

Thank you.

Operator

(Operator Instructions). It appears that we have no further questions at this time. That brings us to the end of the question and answer session. I will now return the floor back to Mr. Andre Esteves, for his closing remarks. Sir?

A - Andre Santos Esteves {BIO 1939152 <GO>}

Well, thank you all for being in our call and expect to see you guys in three months. Okay, thank you very much. Bye-bye.

Operator

I want to thank you, sir and to the rest of the management team for your time today. This does concludes today's presentation. At this time, you may disconnect your lines. Thank you, have a great day, everyone.