Q2 2017 Earnings Call

Company Participants

- JoÃ£o Marcello Dantas Leite, Executive Officer, CFO, IRO & Member of Board of Executive Officers
- Roberto Balls Sallouti, CEO, Member of Board of Executive Officers & Director

Presentation

Operator

Good morning. Welcome to the Second Quarter of 2017 Results Conference Call of Banco BTG Pactual. With us here today, we have Roberto Sallouti, JoÃ£o Dantas, Pedro da Rocha Lima.

We would like to inform you this event is being recorded. (Operator Instructions) 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 August 2 through August 14.

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 BTG -- Banco BTG Pactual's management concerning the future of the business. Such forward-looking statements depend substantially on changes in market conditions, government regulations, competitive pressures, the performance of the Brazilian economy and the industry, among other factors and risks disclosed in Banco BTG Pactual's filed disclosure documents and are, therefore, subject to change without prior notice.

Now I'll turn the floor to Mr. Roberto Sallouti, who will begin the presentation. Mr. Sallouti, please go ahead.

Roberto Balls Sallouti {BIO 4150617 <GO>}

Thank you very much. Good afternoon, to everybody. Starting with Page three of the presentation, Second Quarter results were impacted by a weaker performance of our business lines, which are related to market. This is due to the very strong volatility we had, especially in Brazilian markets in the month of May. So we had subpar performance in Sales and Trading, Investment Banking and also in ECTP, the commodities company which we have a stake. And on the other hand, we had very strong performances on the client franchise businesses. So we had a very strong performance in our Corporate Lending business, strong lending money in both assets and Wealth Management. Both of these businesses are already starting to show a trend of increase in revenues quarter-by-quarter.

And it's the fourth consecutive quarter of positive net new money in Wealth Management and a record quarter of lending money in Asset Management, the second consecutive positive net new money quarter. As I mentioned previously, this quarter was clearly one that we think was subpar. And we expect in the very near future to return to our historical norm of return on equity.

So going back to Page 3. On the Second Quarter, we had total revenues of BRL 851 million, net income of BRL 503 million and adjusted net income of BRL 603 million, basically adjusting for goodwill and extraordinary legal expenses. We have an annualized return on equity for the quarter of 13.3% and a net income per unit of BRL 0.67.

Our cost income ratios normalized have been in line with our historical average. However, on this quarter, our costs were impacted by one-off litigation expenses, letting our cost income a bit above historical average, while the compensation ratio has been in line with the historical average.

And finally, we finished the quarter with total assets of BRL 119.1 billion and a cap Basel ratio of 19%, once again with a very strong conservative and liquid balance sheet.

Turning to Page 4, where we can comment on the results of the first half of the year. In the first half of 2017, we presented a 16.2% return on equity and once again, with very strong balance sheet, capital and liquidity ratios. Just remember, we finished the Q1 with 19.5% capital ratio and 19% in the Second Quarter. And we distributed in the first half of the year 44% of the results as JCP.

We achieved revenues in the first half of the year of BRL 2.5 billion and net income of BRL 1.2 billion with an annualized ROE for the first half of the year of 16.2%. As in the Second Quarter, our cost to income ratio was, for the first half, is a bit above historical average due to these one-off litigation expenses. But normalized, this average and compensation ratio is in line with our historical average.

And finally, we finalized the semester with equity of BRL 18.1 billion and distribution of BRL 630 million to shareholders of JCP.

Turning to Page 5, we show that the numbers basically what I commented at the opening of the call. We had a very weak Investment Banking, Sales and Trading and in Participations with a reflection of ECTP results in these 3 units. It's important to mention that we continue focusing on our core business lines and reducing both Principal Investments and the Participations exposures. This quarter, we reduced the participation in ECTP and expect this to continue in the next quarters. And also, it's worth mentioning the very strong performance by Corporate Lending with BRL 289 million in revenues and solid performance of Asset Management and Wealth Management, which already start showing growth trends quarter-by-quarter.

With that, I'll pass the floor to JoÃ£o Dantas, who will talk in a bit more detail about the different business lines.

JoÃ£o Marcello Dantas Leite

Thank you, Roberto. Good morning. Good afternoon to all of you. So as usually, we will go now into more details in the discussion of the performance of our business areas. We start on Page seven with Investment Banking. The quarter for Investment Banking across LATAM was quite weak. We saw very little levels of activity not only in Brazil. But also in Chile and other relevant markets, which led to our weaker performance in terms of revenues. The normalized level of revenues, which reflects the activity of Investment Banking in the quarter, were BRL 56 million. However, in this quarter, we have to reverse BRL 37 million of fees that had been previously booked. But since the transaction didn't go through, we had to reverse them, which then led to the level of BRL 19 million in revenues.

Nevertheless, I think it's important to say that the 3 franchises of M&A, ECM and DCM continue to operate very well. We see growing level of interest from our clients in terms of potential transactions for the second half. And for next year, we see growing confidence of investors that is gradually coming back post their significant events of May 18. And we see our franchise very well positioned to capture activities and revenue flows from this regain of confidence and comeback of markets.

Turning to Page 8. Here we have Corporate Lending. I'd like to start with the graph on the right side of the page, which shows an increase in our portfolio of Corporate Lending from BRL 20.1 billion to BRL 21.3 billion. This is basically a growth led by the concession of credit through off balance sheet instruments such as letters of credit, since we continue to have a very conservative and prudent approach to preservation of liquidity and preservation of our low leverages in the balance sheet. Nevertheless, we see opportunities to disburse and to concede some credit in these off balance sheet instruments. And we take opportunity to do that, which led to this growth in the portfolio.

My second comment in terms of the quality of the assets is that we maintained the average rating levels. We continue to be very confident with the quality of the portfolio. But regardless of that, we took advantage of the strong quarter to further increase the levels of provisions, which are now close to 5% of the total portfolio, which puts us in a very comfortable position in terms of the level of provisions that we maintained.

In terms of revenues, you see a significant increase from BRL 155 million of revenue in the First Quarter to BRL 289 million in this quarter, basically led by strong performance of our nonperforming loans portfolio. These are primarily transactions that -- portfolio that we acquired with the acquisition of former Banco (Vermilions). But we have other portfolios as well and the business continues to see opportunities to expand and to grow not only the portfolios that we maintain at the bank. But also the business of Enforce, our subsidiary that is focused on corporate nonperforming loan portfolios.

Moving to Page 9. Here, we have a picture of what Roberto already described as a weak quarter for Sales and Trading. The weak quarter comes from basically 2 events. First is the events of May 18, where we had significant disruption, especially in the interest rates market. Then the change of risk perception and the much more risk-averse environment for trading in Brazil that follow that. So the political instability continues to impact the risk appetite of our clients, which leads to lower volumes especially in rates. Regardless of that, we believe that BRL 154 million revenues in the quarter reflect actually very good performance in terms of risk management led by our trading desks, which we believe function very well, given the extreme impact of these events during the days after May 18. Going forward, we believe that the normalization of markets, the continuing movement of convergence of interest rates and the improvement of confidence can lead to normalization of market and normalization of our returns in Sales and Trading.

Moving on to Page 10, we have the performance of Asset Management, one of the franchises that has been performing pretty well. You see at the right chart the significant net new money of BRL 6.4 billion in the quarter, taking our asset under management from BRL 120 billion to 128 -- close to BRL 128 billion, a 5% net new money, which is a significant achievement for the quarter. Revenues are stable since they reflect here in the Second Quarter, basically management fees. And I think it's fair to say that the growing AuM is driven by the top-performing -- top-notch performance in an all fund categories that we manage. Across Lat Am, our equities, hedge funds and fixed income funds have been delivering fantastic performance, all of them in the top quartile, if not the #1 performers in their categories as well as our global macro fund, GEMM. And our rates fund, which -- global rates funds, which outperformed extremely well, too. This is leading to the very significant performance in terms of net new money, gathering of assets, gathering of new relationships and increase in the existing relationships.

We also have some significant -- some landmark transactions in Asset Management. We have the raising of a new timberland deal, where we acquired timberland in Uruguay for $400 million. We have significant new mandates in fund services and we have also new mandates for management of equity funds for certain clients in Latin America. So all that leads us to believe that the performance -- the franchise is performing very well and resuming growth in a constant and strong pace.

Moving to Page 11. We have Wealth Management. Revenues of Wealth Management are stable, growing BRL 2 million quarter-on-quarter from BRL 87 million to BRL 89 million and presenting again strong net new money of BRL 1.2 billion, which is now a sequence that we believe is to be maintained going forward. We believe that our teams are delivering -- continuing to deliver great service and great client coverage. The risk environment in Brazil not different from what impacted performance in Sales and Trading continues to be of cautious in throughout Latin America, especially in Brazil. But despite all these challenges, we believe our Wealth Management area is performing extremely well, benefiting as well from the performance of our Asset Management funds and surprising us constantly with new mandates and new relationships. This is what we expect going forward throughout the year.

On Page 12, we have the results of Principal Investments. I think the first comment we make that really the significance of these nominal results is diminishing over time, which reflects our lower and lower allocation of capital, especially in illiquid strategies. Our performance in the global market allocations, which is basically our seed money to our global hedge funds, was positive BRL (70) million, reflecting the good performance of the fund. And the performance of our merchant banking and real estate portfolios reflect basically the allocation of internal funding costs with no events but the small mark-to-market of our investment in Eneva, which is listed and, therefore, marked against market in the merchant banking portfolio.

Important to highlight as well as already commented by Roberto, the Participations that we maintain the main one is stellar participation in ECTP. The bank has been reducing its stake in ECTP and the negative performance of ECTP in the quarter also impacted our results. And our revenues are, therefore, lower compared to the previous quarter also because of that.

Moving on to page -- to Section 2, Page 14. We will discuss here expenses and efficiency ratios. As you can see, our cost income ratio in the quarter was 58%, compensation ratio was 23%. But we would like to highlight that the adjusted cost income ratio, excluding one-off expense items, was 42%. And in a quarter where we had lower revenues, the 42% efficiency ratio is actually a very good result because it reflects the efficiency of our platform and the ability that we have to adjust the cost base throughout the cycles of revenue generation. Basically, our main expense is the bonus pool, which we have to adjust it naturally by the bonus form that we apply. And in the current quarter, it led to a maintenance of our good levels of efficiency at 42%. The one-off administrative expenses are related to legal costs incurred in connection specifically with our investment in Switzerland, where these costs are being incurred now in view of the potential recovery of revenues and value in these investments going forward. So we see this as an investment that we are doing with a good expectation of generating positive impacts to our equity in the near future.

Also to highlight in this page is the positive line of income tax. This is because of the weaker performance in a quarter where we record the payment of deductibles business expense in the form of JCP.

Moving to Page 16. Here we have the future of our balance sheet, which looks pretty stable as compared to the First Quarter of 2017. Assets are -- total assets are smaller in BRL 6 billion going from BRL 125 billion to BRL 119 billion. As a result, we have maintained a very strong Basel ratio of 19%, a very strong liquidity coverage ratio, which is short-term measurement of liquidity, at (160%), which today is double -- is 2x the minimum required ratio by regulators. And what we see here is a picture that we expect to maintain in the following quarters in the short to medium-term since we continue to apply preservation of capital prudence and conservative -- and a conservative approach to the balance sheet. I think it's important to highlight that the current levels of capitalization, liquidity and leverage are even stronger than those that we had right after our IPO in 2012. By the end, we had a leverage of 9x equity capitalization ratio, very similar to the current one. And although we didn't apply LCR at that time, if we had applied, we would compare the current liquidity levels at even higher than those that we maintained right after our main capitalization in our history, which was the capital raising of our IPO. So we have the best ever, the strongest ever and the highest ever liquidity, which we expect to maintain while we see still room for stabilization and improvement of the environment in Brazil, especially in Brazil and throughout Latin America.

This -- moving to Page 17, this can also be perceived by looking at the broader credit portfolio. It grew from BRL 26.5 billion to BRL 28.2 billion in the quarter, basically due to the concession of credit through off-balance sheet items and also due to a smaller extent, to credit from our partnership financings since we have changes in partnerships in the previous year.

Going forward, going to Page 18, we have the unsecured funding base. And today, as you know, the unsecured funding base reflects the needs of the business. It's stable with higher percentages of renewal of liabilities and also with an increasing tenure or average tenure for our funding instruments. Funding continues to be well-diversified across regions, across types of money instruments and across different types of counterparties in the borrowing base. And we don't need to expand it because the funding for the business is functioning well with the current level of unsecured funding base.

Going to Page 19. We have the final page where in conclusion, we maintain the 19% Basel ratio, which in comparing to the 21.5% Basel ratio we have in the end of 2016, today's ratio is actually slightly stronger. What happened between the end of '16 and today is that Basel III continues to kick in, in the phased implementation. The adjustments that were made are actually higher than the 1.5% reduction in the index. So we continue to maintain very liquid and also very tangible assets in our asset base, which contributes to our strong capitalization, which is intended to be maintained. And as a consequence of the comments about markets that we made before, you see that we reduced our exposure in terms of daily average VaR, which reduced it from 0.65% to 0.57% of average equity in the quarter.

So that will conclude the performance comments. And we can then pass to questions that you may have. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) 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>}

Once again, thank you all for joining the call. We hope to see you at the end of Q3, where we report results, where we expect to have returns to what is the historical norm of our quarterly results. So thank you very much. Have a good day. Goodbye.

Operator

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