Q2 2016 Earnings Call

Company Participants

- Joao Marcello Dantas Leite, Executive Officer, CFO and IRO
- Marcelo Kalim, Co CEO

Other Participants

- Felipe Salomao, Analyst
- Unidentified Participant

Presentation

Operator

Good morning and welcome to the Second Quarter of 2016 Results Conference Call of BTG Pactual.

Here with us here today, we have Marcelo Kalim, Joao Dantas and 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 August 10th through August 16th.

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 changes without prior notice.

Now, I will turn the floor to Mr. Marcelo Kalim, who will begin the presentation. Mr. Kalim, please go ahead.

Marcelo Kalim {BIO 16142515 <GO>}

Good afternoon, everyone. Thanks for attending this conference call. We will start with some brief remarks and then pass along to our CFO, Joao Dantas, to go deeper into the presentation. And after we finish, we will be open to Q&A as usual.

We are very pleased to announce the results for the second quarter, not only for the results themselves, but because I think we can now present a very clear picture of the bank, after what we are calling our strategic repositioning of the bank.

As I said, we are very pleased to announce the results because we were able not only to do this repositioning with very strong results, but further than that, to have a much clear view on our business lines and more important also a very strong and liquid balance sheet as we are going to see.

So as I said, it's a very important quarter to show not only the results, but the stage of the business that we are after all the position -- repositioning that we've been announcing in the past six months or so. So, without much further ado, let's start with the presentation. We can start on page three, where we have the performance summary for the second quarter of 2016.

For the second quarter, we had net income of BRL2.6 billion and 940 million of net earnings, which constitutes an annualized return on equity of 16.1%, which is a little bit below what we would expect and what we believe to be our medium-term goal. But as we said, given the repositioning that we are doing, we are very pleased with the results, and being able to adjust the bank on the flight, let's put it like that, and churn [ph] BRL940 million profit in the middle of this process, I think that make us very proud.

Net income per unit reached BRL1.07, which is increasing since through our buyback program, we are decreasing the number of units issued to the market.

Labor and administrative costs, we achieved a reduction on that based on the cost reduction initiative that we initiated in the beginning of the year.

Cost to income ratio reached 61% for the quarter, but BTG Pactual standalone, the ratio was 44%, which is very much in line already, what we'd expect to be the normal ratio. Comp ratio 33% and BTG Pactual standalone 25% also in line what we would expect.

It's worth highlighting that we have extraordinary expenses related to the BSI divestments and also some legal fees in our BSI units [ph] that were reported by the press in the past couple of months.

Total assets in our balance sheet reached BRL213 billion, 9% lower than the first quarter, 20% lower than the end of last year, which shows that we are continuing our efforts on decreasing the complexity of our business, decreasing leverage in our balance sheet and making our balance sheet much stronger and liquid as we're going to see.

We believe this trend probably is over, and now we are at a level that we believe it's ideal to sustain our business in this new more challenging environment.

The average value at risk decreased to BRL223 million, which corresponds to 0.96% of the average shareholder's equity. That's a decline from 1.16 from the previous quarter, as you can see in the bottom right-hand page, the graph on the bottom right-hand page.

This is also a very starking remark of BTG Pactual, as you can see our value at risk does fluctuate from quarter-to-quarter based on our appetite or the market conditions, especially for our sales and trading operation. And again, we saw more adverse markets than (inaudible) our exposure in the value at risk.

Our book value per share reached BRL26.58, and as we can see, this represents a growth every single quarter, since we've been a public company.

Turning to page four, we have the performance summary for the first half of the year. And here the figure is more or less the same, we reached BRL6.2 billion of total revenues and BRL2 billion of net earnings. 6.2 is a record number for us and BRL2 billion means that we had a return on equity of 17.5% for the first half of the year.

The first quarter of course was better than the second, but overall in six months, we able to present this kind of ROE, as I said, we've repositioned the bank on the flight, we are very pleased with the outcome, not only for the results that we are presenting, but more than that, the position that we have today. Being able to focus on our business going forward, not having to worry about problems in the past, very well capitalized going forward, and with cost are under control as we can see for the quarter as well.

So, we believe this phase of repositioning is over, probably for the next quarter, we will be able to show also the balance sheet without the integration of BSI that we believe is going to be completed and merged with EFG and also with the spin-off of ECTP and that probably will conclude of this transition period.

Also to point out here, we announced a JCP of BRL500, we haven't paid that yet. We believe we are going to be able to pay that, however, at the end of the year and even with this payment together with the one that we announced last December, our shareholders' equity increased from BRL19.8 billion against to BRL23.5 billion, which after the roughly 1 billion JCP, it's a 19% increase year-to-year.

So, we can clearly show here that it is very turbulent period, we not only able to pay back money to shareholders, but create significant value to all of our shareholders, increasing our equity by BRL3.7 billion and distributing this BRL1 million that I mentioned. So, as I said, we are very pleased with this picture.

Turning to page five, we have the breakdown of revenues by area, very diversified, as you can see with the -- with the highlights being sales and trading pretty strong for the quarter and pretty strong for the half as well. And the negative highlight would be principal investment albeit in a smaller number BRL211 million negative compared to more or less 500 in the first quarter.

I think that's concludes our brief introduction. I would like to turn now to Joao Dantas, to go into the presentation in more detail. Dantas, please.

Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Thank you, Kalim. We move to page to page seven with investment banking performance and we start looking at that. So, Investment Banking, basically we had a very weak first half of the year, very weak quarter in terms of capital markets activity in LatAm. Regardless of that, our Investment Banking department has performed well. Most of the BRL80 million revenue we report, comes from M&A activity and a smaller portion comes from debt capital market activity, where we saw interesting opportunities for some advisory on debt restructuring to Brazilian companies, something that we believe will continue to happen.

In the first half, we have advised to about 40% of the deal volume of M&A in Brazil, which puts us comfortably in the leading position in the M&A leads, as it has been the case for now a long time.

Moving to the next page, corporate lending. As you see, we had growing revenues in the second quarter compared to the first quarter of '16 when compared to the fourth quarter of last year. BRL276 million of revenues, which is a interesting phenomena since we have growing revenues, despite having a lower portfolio. This is explained by higher credit spreads on the transactions that are coming in the portfolio compared to the ones that are exiting the portfolio as well as revenues from non-performing loans.

Important to note is, we have a 50% reduction in portfolio, if you compare the third quarter of 2015 with the current quarter end. And we were able to do that with no material negative P&L, which means that not only the quality of the credit assets we held in our balance sheet was very high, as we always had, but also that the -- the much [ph] of the portfolio were adequate or as we like to say conservative in our books. This is also a statement to the quality of the execution, since most of the divestments of the credit portfolio happened in the course of less than two months during December and January.

We continue to manage our balance sheet prudently, but we believe that this level of credit assets is now stabilizing and the current levels that we see are perhaps going to be the new normal for our credit portfolio going forward. We don't expect -- may have, but don't expect any further reductions in the portfolio. The portfolio remains at good quality and well provisioned.

During the quarter, we saw the average ratings increase. We saw the amount of overdue loans reduced significantly, and we have a percentage of provision to the credit portfolio, which we consider high and adequate for the current scenario of Latin America.

Moving on to page nine, we see the performance of Sales and Trading. So, we have reported BRL1,147 billion of revenues with -- which compared to the previous quarter and the fourth quarter of '15 is a reduction in revenues.

However, we believe this level of revenues is actually very adequate and strong. If you compare the current quarter with the average of 2014, we have 60% -- 65% more revenues then we had during 2015. And the level of revenues of the second quarter is also in line with the average revenue of the 2015 quarters.

So, we believe this is significant performance, especially given the fact that we reduced the allocation of VaR, especially in FX and in commodities. And also since in the first quarter of this year and the last quarter of last year, we had gains from the repurchase of our own ability. This is not the case in the current quarter, since our debt resumed trading at normal levels now.

We believe that our sales and trading performance indicates that we are taking opportunity well, from the very liquid balance sheet that we have. We continue to be dealers of interest rate and FX for Central Bank of Brazil. We continue to be actively engaged in trading with our counterparties, and that makes us confident that Sales and Trading will continue to be an important contributor to our revenues and performance going forward.

Going to page 10, we look at the performance of Asset Management division. We are recording a BRL130 million, which is lower than the first quarter of '16, and the last quarter of '15. Typically the second quarter revenues in Asset Management are lower than the average of the year, because it's a quarter, where we typically don't recognize performance fees from our mandates with funds.

Performance is typically recognized within the last quarter of the year and the first quarter. Not only that, but the drop in revenues, of course, they reflect the drop in AUM, that we saw. Regardless of that, Asset Management is still a profitable business for us.

Important to note that the outflows that we saw along the year have stabilized. The negative net new money that we see in -- during the year, it reflects basically redemption requests in the past that were executed during the year, some of the transferences [ph] of custody and transferences of fund services take time to implement, because the new service provider has to adapt systems and be ready to receive the new funds.

And what we see actually more towards the end of the quarter is positive inflows, net new money is positive by the end of the quarter, we actually see lots of open initiatives and opportunities in asset management for us and our funds have been delivering good performance, which makes us confidence for this business -- confident for this business.

Moving to page 11, we see the performance of Wealth Management. And first of all, I would like to point out the comparison of revenues from the first quarter and the second quarter, which is impacted by outsized revenues in BSI Wealth Management business in the first quarter. What happened is basically that BSI sold a stake in a subsidiary at a profit in the first quarter as we reported, and this increased the revenues in Swiss francs coming from BSI Wealth Management.

Also, we had a drop in revenues in reais since the real has appreciated against the Swiss franc in the period. Not only that, but we also see at the bottom of the bar, the darker blue color, you see a reduction in revenues in our Wealth Management business, which of course is a reflection of lower AUM.

Here is the same case of Asset Management, we see the outflows as -- during the year as a result from past request of redemptions. These outflows have stabilized and what we see by the end of the quarter are actually inflows.

I think it's important to mention, our -- most of our clients recognize the value of our actions during this stress period, with no funds being closed, no gates being posed [ph], all redemptions were duly honored. Our clients now are coming back and that makes us very proud of the fantastic job done by our teams both in Wealth Management and Asset Management.

Moving to page 12, we look at Principal Investments, we see revenues of BRL5 million on Global Markets, BRL16 million in Real Estate and negative revenues of BRL231 million is Merchant Banking.

In Global Markets, the positive revenues reflect basically the positive performance of the global hedge funds, since most of the capital allocated to Global Markets is now seed money to our fund clients. The revenues are smaller than what we saw in the past because the size of our allocation to Global Markets has reduced significantly.

In Merchant Banking, the negative revenues they reflect basically mark down in oil and gas investments, which are now marked at zero. And in real estate, our profits reflect the gains from the sale of our stake in BR Properties.

Moving to section two on page 14, we look at expenses and main ratios. And we believe the best analysis is depicted by the table on the bottom part of the page, which shows the ratios for BTG Pactual standalone.

Our efficiency ratios for BTG Pactual stand alone are in line with our historic levels. We have implemented significant cost reduction initiatives and the benefits of that are still not fully captured in the P&L. Because in the second quarter, we still have some costs from especially from the redundancy program that we implemented.

I think that reaching 44% of cost income ratio and 25% of compensation ratio shows the flexibility of the business model that we have, when we have lower revenues we are able to run the bank with lower costs. This is, of course, a feature that we always mentioned before and we are able to show with the facts of the quarter. So, the flexibility of our business models is one of the attractiveness of the business model for the bank.

Finally, if you look at the income tax rate, you see that the tax rate for the quarter was lower benefiting from the payment of -- declaration of JCP and our revenue mix a more beneficial to the income tax rate.

Moving to section 3 on page 16, we look at the balance sheet, and here some interesting figures in line with what we -- what Kalim mentioned in the beginning. We continue to manage our balance sheet prudently and conservatively.

Our total assets continued to reduce 9% in the quarter on top of the 20% reduction on the first quarter. This is now reaching a level, which we consider to be a new normal and we believe that the level of assets that we carry are now going to be stable going forward.

Looking at funding, our secured funding base is stable. This is basically the financing -- the self-financing of marketable securities and financial assets, unsecured funding has reduced due to the maturity of our liabilities, and the current level of unsecured funding, we believe is more than adequate to finance the new normal level of our balance sheet.

Our equity and perpetual bonds have remained stable with the equity growing and the perpetual going slightly down because of the FX impact, since the perpetual bonds are denominated in dollars and there was appreciation of the real in the period.

The credit portfolio continued to reduce and reaching now the level that we consider to be, as we mentioned the new normal. And again the funding level that we have for unsecured fund, we believe this is more than adequate to finance the level of our assets we intent to keep, as you can see by the coverage ratio that is now at the 192%.

Also it is important to note that the unsecured funding maturity has increased a lot since most -- almost all the funding that we redeemed was on the short-term portion and the capped long-term funding in our balance sheet, we will see that in the next pages.

Finally, in terms of cash and cash equivalents; our liquidity buffer in high quality liquid assets that we maintain at BTG Pactual have increased in the quarter and slightly decreased in BSI, in Reais moreover because of the appreciation of the real.

The LCR for BSI is at 175%, which is adequate, very adequate for a bank like BSI that benefits from demand deposits and is at a 138% for BTG Pactual, which is also extremely positive for an investment bank, which doesn't count with demand deposits as well as doesn't incur in the cost of maintaining a network of branches.

Moving to page 17, we look at the broader credit portfolio. These figures include the portfolio of credit of BSI. If we look at right portion of the page, which is the behavior of the broader credit portfolio by product, and we look at the variation from the third quarter of 2015 to the second quarter of 2016, we see that the reduction, the total reduction was about 37 billion, about 40% of that was reduction in BSI, mainly due to FX change, which variated a lot and there was a lot of appreciation of real in the period and about 60% in BTG Pactual mainly from sales and the natural maturity of our portfolio. This for BTG Pactual represents roughly 50% reduction in the portfolio.

Important to note again that we implemented that reduction without any significant, any material negative impact in P&L. And as we mentioned before, we believe that the level of credit assets in BTG Pactual balance sheet is now coming to -- becoming a new normal level for us.

Next page, page 18, is the Unsecured Funding base also including the BSI Funding. Basically BSI and BTG Pactual funding basis are equivalent in size. So, roughly 50/50 from each -- each of the entities and this new level of funding as we mentioned before is adequate to finance the balance sheet that we intend -- the balance sheet size we intend to maintain is also -- and also continues to be well diversified across all the funding sources that we have access.

And finally on page 19, we have Basel ratio and VaR. Looking first at the VaR, we have -- we see here a reduction in the deployment of market risk, basically that comes from the portfolios of commodities and FX. As we mentioned before, we also had a reduction in the capital usage for credit risk, since we had reduction in the portfolio.

But counterintuitively, we see a decrease in the Basel ratio that is explained by two factors. First, as you know Basel risk and VaR both look at averages, but the Basel ratio tends to look at longer trailing period for the averages. So, the reduction of the VaR of the capital deployment in market risk is going to represent a slight increase in our Basel ratio still going forward.

And another point is that some of the hedges that we've placed in commodities to manage down our risk usage, they count [ph] negatively on the Basel capital model, actually they add capital requirements, which is okay since we are doing the spin-off of the commodities division very soon.

Important to note as well, that after the BSI sale is completed and the commodities spin-off is implemented, our Basel ratio will reach something around 20% of total capitalization, which we consider to be actually higher than what we need to run the business in a sustainable manner.

Well, this ends our comments on performance, and now we can open for Q&A.

Questions And Answers

Operator

The floor is now open for questions from investors and analysts. (Operator Instructions) Our first question comes from (inaudible) of Credit Suisse. Please go ahead.

Q - Unidentified Participant

Hi. Many thanks for taking the question, many thanks for the presentation. I have one question in regard to BSI. Could you comment on the trend of the asset flows and how that has been now in July? Many thanks.

A - Marcelo Kalim {BIO 16142515 <GO>}

Thanks for the question regarding BSI. Of course, after the -- the funds that we were now (inaudible) a month ago, we had a negative outflow -- a negative outflow that has been completely stabilized. And for the month of July, I would say the asset flow is pretty much stable at this point.

I think this news [ph], I can't remember if they hit in June or May, I don't remember exactly. But for the month of July the assets flows are completely stable.

Q - Unidentified Participant

Many thanks.

Operator

(Operator Instructions) Our next question comes from Felipe Salomao of Morgan Stanley. Please go ahead.

Q - Felipe Salomao {BIO 19237023 <GO>}

Hi, good morning. Thank you very much for the opportunity to my questions. I have one single question. During -- during the presentation, you mentioned a bunch of times that BTG is now running on its new normal, after the, I mean, considering the new structure of the bank.

And under this new normal, the Bank delivered an ROAE [ph] of 16%. So, my question is, do you understand that the recurring ROAE level of BTG from now on considering also the, I mean, the change that BSI and the changes at Engelhart will be 16%. Or I mean, is this the new -- new recurring level? Thank you.

A - Marcelo Kalim {BIO 16142515 <GO>}

Actually, thank you Felipe for your question. It's a good opportunity to clarify a couple of points. First, I would like to highlight one -- one specific aspect of our performance, which is the 16.1% be the ROAE for the Group. If you separate, what is the investment company, and what is the investment bank, the investment bank return in the quarter was 19.5%. This is much more in line with our core business capacity of generating revenues, since the investment company is becoming less and less relevant for the business, as we have been reducing the size of our allocation to illiquid assets into Global Markets as well as we mentioned.

So, I think for the quarter, if you look at the core performance of the Bank, you have a much clear picture of what it can deliver in terms of results in our core businesses.

Not only that, we think that the first quarter was clearly a very weak quarter for Investment Banking activity to other region we had, almost no activity in ECM, very low activity in DCM, and again no recording of performances from our funds, which as we mentioned have been performing very well.

So, with all that in account, and the fact that the fruition of the benefits from the cost reduction initiatives is still materializing through the P&L, we wouldn't think that we wouldn't say that the current levels of performance are in line with our expectation for the future.

We think that our expectation for returns for the future with the new lighter, assets lighter model that we have are actually going to be off performances higher than we saw in the past. With a more liquid and more -- and lighter balance sheet, we believe the Bank will be able to deliver higher ROAE than our expectations for the past actually.

Q - Felipe Salomao {BIO 19237023 <GO>}

Okay. That's very clear. Thank you very much.

Operator

Thank you. That brings us to the end of the question-and-answer session. I will now return the floor to Mr. Marcelo Kalim for his closing remarks.

A - Marcelo Kalim {BIO 16142515 <GO>}

Again, thank you very much for attending this call. We hope to see you in the next quarter. Thanks and have a good afternoon.

Operator

Thank you. This concludes today's presentation. You may disconnect your line at this time. Have a nice day.