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Q3 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

Other Participants

- Carlos G. Macedo, VP

Presentation

Operator

Good morning. Welcome to the Third Quarter of 2017 Results Conference Call of Banco BTG Pactual. With us here today, we have Roberto Sallouti, JoÃ£o Dantas and Pedro da Rocha Lima. We would like to inform you that 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 November 8 through November 15.

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 aspects of Banco BTG Pactual. These are merely projections and, as such, are based exclusively on the expectations of Banco 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 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 morning, everyone. Thank you for joining the call. If you could start by the Page three of our presentation, we just wanted to make sure that we gave

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you guys an update on the share and bond buyback program that we've been doing for the last few months.

So since 2015, we have been actively repurchasing our own bonds and running a share back -- buyback program. And we have now decided to cancel part of these bonds that were acquired. So we're announcing the cancellation of USD 300 million of the senior 2020 bonds and the USD 350 million of the Tier 2 2022 bonds. We also announced a few days ago a tender offer to repurchase up to USD 390 million of our perpetual bonds, which are considered Tier 1 capital. We expect this repurchase of the Tier 1 perpetual to impact our capital ratios by around 100%. And also, it's also -- sorry, not 100%, 100 bps. We also continue acquisition on a share buyback program. Last quarter, we canceled 16.2 million units. And we have a new buyback program of 15.5 million units that was approved in October.

Turning to Page 4. We talk a bit about Third Quarter results. We are very satisfied with a very solid performance for the quarter, especially the very solid performance from our franchise businesses. So for the Third Quarter, we had total revenues of BRL 1.6 billion and adjusted net income of BRL 759 million, which means an annualized ROE for the quarter of 16.5%. This means a net income per unit of BRL 0.85.

Our recurring cost ratios are in line with the historical average. So our cost-to-income ratio was at 43%. And our comp ratio was at 22%. And we continue running a very conservative and liquid balance sheet. So we finished the quarter with total assets of BRL 113.7 billion, with a leverage ratio of 6.1x our equity and a Basel ratio of 17.3%. This capital ratio reduced a bit from the Second Quarter basically because of an increase in the usage of market risk. And this can be seen by the increase in the average VaR of the quarter to 71 bps of our equity.

Turning to Page five and talking about our 9-month performance for 2017. We have an adjusted ROE for these nine months of 16.2%, which is in line with our expectations, especially because, as I mentioned previously, we continue to have a very conservative and liquid balance sheet. Notwithstanding, most of our business areas are performing very well. And all of them are showing consistent and constant growth. So for these nine months, we've had revenues of BRL 4.2 billion and adjusted net income of BRL 2.2 billion. Our cost-income ratios again have been in line with historical averages, 46% for cost income and 22% for comp. And we finished this period with equity at BRL 18.6 billion, which means a book value of BRL 20.82 per unit.

Turning to Page 6. We talk a bit -- we show a bit the revenue breakdown for the quarter and for the nine months. I will just talk here about the quarter revenues. And then Dantas can go into more detail for each business unit.

Investment Banking. The revenues clearly did not symbolize or reflect what was the level of activity and what is the level of the pipeline. We have concluded a large number of transactions, which we still have to see the revenues flow through our income statement. So we expect that these revenues should go -- grow in the next few quarters.

Our Corporate Lending business is basically in line. We did not have any extraordinary revenues from our special situations or NPL businesses this quarter as we have last quarter.

Sales & Trading was definitely the highlight of this quarter. We had a very strong performance, which basically compensated for the weak performance we had in the Second Quarter due to the excessive volatility that we had in May given the political developments in Brazil. But if you look at the 9-month revenue of Sales & Trading, it is basically what we considered a normalized business for us.

And last but not least, it's very important to mention the solid performance of Assets and Wealth Management where we continue seeing constant growth quarter-after-quarter, which means that we are utilizing the operational leverage that we have in our platform. And we expect that to continue over the next few quarters.

So with that, I'll pass the word to JoÃ£o Dantas. And he can give a bit more detail about each of the business units.

JoÃ£o Marcello Dantas Leite

Thank you, Roberto. So now we go to comments on the performance of the individual businesses. And after that, we'll comment on the asset and liability and balance sheet items.

Just before we start, I think it's projected that we share with you a little bit of the background. What we have been seeing in the last few months is significant efforts and important successes on the economic adjustments and reforms agenda in the country. That has been giving cause to an increase in confidence from private agents, sustainable drop in interest rates and the recovery of the economic activity that is noticeable. These effects can already be seen in the performance of our business areas, as we will see in the next pages, as well as on the quality of our assets, which has been maintained strong.

So flipping to Page 8. Here, we see Investment Banking. And you can see that we have had in the quarter BRL 51 million of revenues. So the economic activity -- the increase on economic activity that we mentioned has not been captured on the revenues. But if we look at the backlog and the pipeline, both are reflecting the economic activity recovery already. On the backlog, we have significant number of M&A transactions that have been signed but not yet concluded due to the necessary regulatory approvals. And on the pipeline, we see strong capital market activity going forward all -- not only on debt capital markets but also on ECM.

I think also important to highlight, in the bottom right part of the page you see, is our market position. Debt market position is a continuation of our leading position in Investment Banking in Latin America debt not due to economic recovery. That's due to the quality of our professionals and of our client relationships, which make us very proud.

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Turning to Page 9. Here, we see the Corporate Lending results. In terms of revenues, we've reached BRL 183 million, significantly less than last quarter. But the vast majority of the revenues in the quarter are revenues from the regular Corporate Lending business. We didn't capture significant NPL portfolio revenues this quarter, contrary to the previous quarter where there were significant revenues coming from NPL. These revenues are one-off. And we typically recognize them once we have cash. And the BRL 183 million reflect actually a very healthy return and spread from the Corporate Lending portfolio. But besides that, I think it's interesting to note, it's the Third Quarter in a row where we have a moderate growth in our Corporate Lending portfolio.

We also had an increase in the credits provisions in the quarter. We are reaching a level of 5% of credit reserves, which keeps us very comfortable. The quality of our assets continues to be strong and spread, as I mentioned, continue to be very adequate. We are seeing in the market many companies are coming with good projects in search for support on credit. And we think that this creates a positive environment for Corporate Lending in the country going forward.

On Page 10 is the results of our Sales & Trading activities. Here perhaps is where we see better the impact on revenues from the recovery of economic activity we are seeing after Second Quarter, as Roberto mentioned, marked by a few events that brought significant volatility and uncertainty in FX and fixed income market, especially in Brazil. We see a Third Quarter where we have bigger flows on our flow businesses and the expression of the wider confidence in markets that also was reflected in stock exchange indices. And so this allows us to capture revenues. And we see the flows coming back.

Moving to Page 11. Asset Management revenues are pretty stable. In the 3 quarters of the year, we had basically the same level of revenues. This quarter, BRL 111 million. Those revenues reflect essentially management fees. There is no capture of performance fees yet because these come more towards the end of the year. But also, it's important to note that we have, for the Fourth Quarter in a row, growth in our AuM and significant inflow of net new money.

Quarter-on-quarter, the growth in AuM is partially explained by net new money. But more than the net new money impact, you have also the impact of asset appreciation. So AuM has appreciated in -- as a result of good performance in the quarter. We also see that our funds are performing on top-tier quartile in all its categories. And from that, which is a continuous effect since the beginning of the year, we see good capital raising in all asset classes.

There are many mandates, important mandates not only coming back. But also new mandates from institutional investors, from individuals, et cetera. So the trend is very positive. And we see that also has an impact from the convergence of interest rates, which is very positive to our Asset Management platform.

Moving to Page 12. On Wealth Management, revenues have increased quarter-on-quarter. We have reached BRL 94 million of revenue. This comes not only from growth in wealth under management. But also from more activity in markets from our clients. So both are signs of confidence coming back. Net new money in the quarter was negative BRL 0.7 billion. But that has a one-off impact of custody assets that were transferred during the period. But that the impact was compensated strongly by significant inflows, good money coming in, various mandates distributed across asset classes, geographies. So the good performance of our own managed products, the good advisory for selection of assets managed by others, good services are contributing to this sequential growth, from the fifth quarter in a row, of AuM of wealth under management in our Wealth Management platform.

Moving to Page 13. Here, we have the results for our principal investments, which are, first of all, small. Positive results coming from global markets, which reflect basically the capital allocation on some of the funds that we -- that our Asset Management division manages, especially international macro and hedge funds. So those are performing well, contributing to the capture of revenues that has been increasing along the year.

Results in Merchant Banking and real estate are small and basically no significant events. We didn't have any disposal of assets. In Merchant Banking, we have just captured the equity pickup, share of profits from our investments. And that compensates most of the internal funding cost that we allocate to the positions. In real estate, this is basically the internal allocation of funding cost.

Before we move to the analysis of expenses, I would like to highlight also good performance that we see coming from our offices throughout Latin America. We have launched successfully our new broker dealer in Argentina during the quarter, which is up and running. We have been seeing mandates coming from Mexico, Peru, Colombia, Chile. We are in all-time high of assets under management in Colombia and Chile. And in Chile also, our investment bank franchise is operating well, raising local funding, doing also corporate lending activities. So not only the recovery of economic activity benefiting us in Brazil. But also across the region where we have a very strong franchise developed right now.

On Page 15, you can see the analysis of expenses. And on the third column, you see the Third Quarter 2017 ratio. Cost-income ratio was 43%. Compensation ratio, 22%, pretty much in line with our historical performance. For the full year, the 9-month period of 2017, we show 46% of cost-income ratio. But if you exclude basically goodwill and one-off legal costs, the cost-income ratio for the 9-month period of 2017 would have been 36%.

So this shows that while we see growth in activity and growth in the business areas, capacity to generate more revenues, we also do that without increasing our cost base because we still run the bank with significant operational leverage. And we expect to keep it like this. In other words, seeing more economic activity doesn't mean a pressure on our cost base going forward.

Also important to highlight in this page, on the Third Quarter of 2017, we show here an effective income tax rate of 46.7%. But this is actually due to the one-off impact of adhering to a tax amnesty program in the country. But if you exclude for that impact, the regular income tax rate was 28%. And in fact, we should do that. Because to compensate

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for the cost of adhering to this amnesty program, we promoted nondiluted capital increase of the same amount, which functions to all investors just as a profit because it grows proportionately the equity to all the investors. So in effect, the effective income tax rate was 28% for our shareholders.

Moving to Page 17. You can see here the balance sheet. Total assets are pretty stable, no significant change. We went from BRL 119.1 billion of assets to BRL 113.7 billion. This is just from the flow business. We have less trading assets -- less trading liabilities. So secured funding has reduced as well as portfolio trading assets. But the structural portion of the balance sheet keeps stable. We are running the bank with 6.1x leverage. And the liquidity coverage ratio is very high today at 158%. So it's basically double of what's required from a regulatory perspective. And we keep -- we expect to keep it like that for the short, medium term.

Next page, you can see the broader credit portfolio, which is stable. This comprises not only the Corporate Lending assets. But also other credit exposures. And as I said, it's a stable portfolio at this point.

Next page is the unsecured funding base. We're running the bank today with 31.5% of unsecured funding, a small drop from the BRL 33.2 billion of unsecured funding that we had in the end of the Second Quarter. But we still keep more than 200% ratio of unsecured funding to Corporate Lending portfolio. The on-balance sheet asset -- credit assets require less than 1/2 of what we have in terms of unsecured funding, which keeps us very comfortable that this funding base is extremely adequate at this point for us to keep high liquidity and a growing credit portfolio.

And in the last page, on Page 20, you can see Basel ratio and VaR. We are ending the quarter with 17.3% of Basel ratio, which has dropped from the 19% on the end of the Second Quarter due basically to more utilization on Sales & Trading debts. And you can see that also on the increase of the daily average VaR and the percentage of average equity, which went from 0.57% to 0.71% in the quarter.

As we always highlight, these measures, usage of VaR, usage of risk in general and Basel ratio, they will change as we see opportunities. This is not a structural increase. This is just a reflection of the opportunities we had in Sales & Trading in the quarter.

So with that, we end our comments and we open for Q&A. Thank you very much. And we'll wait for your questions.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Carlos Macedo with Goldman Sachs.

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Q - Carlos G. Macedo {BIO 15158925 <GO>}

A couple of questions. First question, your VaR did increase. You noted sales and trading revenues were higher, as noted as well. To what degree can you correlate Sales & Trading -- the increase in Sales & Trading revenues with the VaR? Is it something that's 1:1? Or in this quarter, was it something that was driven by making the right calls with taking this risk? I mean, how should we think about Sales & Trading going forward given where VaR is? Do you need further increase in VaR to keep results that high? Just trying to get an understanding of how to think about this specific line once more. Second, going back to your banking business. A big pipeline, as you said, that might come on the M&A side. I assume that not too many deals closed this past quarter, which is why the revenues were lower or low relative to prior periods. Is there a timetable for closing in these things? Are there pending regulatory approval? I mean, is this something that we should expect in the fourth and First Quarter? Or is it going to be over a longer period of time that we're going to see these revenues come in?

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

Carlos. So answering your first question, it's very hard to give you a correlation. This quarter, I would say that it was both getting the directions right and an increase in client volumes from a larger-risk appetite from the investment community given the macro scenario in the region. To think about a normalized business, I think the best way to look, as I said during my opening remarks, the 9-month revenues for 2017 look to us at what our normalized business should be in 3 quarters. Naturally, you have some volatility from quarter-to-quarter. But we think that is the best indication of what we think is a normalized business. And you can see that throughout -- when you look at the VaR in those quarters, they vary around, I don't know, 60 bps, 55 bps, which is exactly as we increase the directional or we have temporary exposures to manage down the big flows that we are giving liquidity to. On your second question, it's very hard to say. But we probably expect the revenues to be booked in the next 2 to 3 quarters. And as you said, yes, there are pending regulatory approvals or conditions to closing, especially for M&A, which still need to be executed.

Q - Carlos G. Macedo {BIO 15158925 <GO>}

Just going back to the VaR question. So if you -- if I just take the last 3 quarters and divide by 3, it's around BRL 600 million per quarter. That would be a -- as difficult as it is to get the run rate right, that would be a run rate that you'd be comfortable with for the Sales & Trading?

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

With volatility from quarter-to-quarter. But we think that if you do an average -- a moving average, that is very close to what we consider normalized business, yes.

Operator

(Operator Instructions) At this time, I'm -- excuse me. At this time, I'm showing no further questions. I will not return the floor to Mr. Roberto Sallouti for his closing remarks.

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

Once again, thank you very much for joining our quarterly call. We hope to have you joined at our next call where we talk about full year results. Thank you very much. Have a very good day.

Operator

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

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