Q3 2014 Earnings Call

Company Participants

- Andre Esteves, CEO
- Marcelo Kalim, SVP & CFO

Other Participants

- Carlos Macedo, Analyst
- Mario Pierry, Analyst
- Saul Martinez, Analyst

Presentation

Operator

Good morning. Welcome to the Third Quarter of 2014 Results conference call of BTG Pactual.

With us here today, we have Mr. Andre Esteves, Mr. Marcelo Kalim, Mr. Joao Dantes. And Mr. Pedro de 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.

(Operator Instructions)

Today, we have a simultaneous webcast that may be accessed through the website, www.BTGPactual.com/IR. There will be a replay facility for this call for a week from November 5th through November 11th.

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 change without prior notice.

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

Andre Esteves {BIO 1939152 <GO>}

Good afternoon, everybody. Thank you very much for being together with us on the call. I will do an introduction about our results and then our CFO Marcelo Kalim will describe deeper with our business area by area. Then, of course, both of us will take your questions.

Well we are very glad with the results. Results were (inaudible) of BRL1.7 billion and net income of BRL769 million. Once again, I think we have good results in a weak environment in terms of economic activity to our capital markets activities.

And the pre-tax earnings were basically lined around BRL1 billion, which is basically the same of last quarter, which was record quarter for us. So we like that the form is especially in this environment.

The return on equity on the (inaudible) was likely below because of a little bit more taxes than the average. So around 17.3% with unreliable numbers around 20%. I will talk about that soon.

Expenses remain under control. Of course, income basically the same of 41%. Compensation ratio at 19%, also (more) the line. Nothing new here. Corporate assets were slightly above of last quarter at BRL204.6 billion.

And BASEL index was exactly the same at 16%. And important information that as most of you noticed, we issued tier 1 capital in the Third Quarter. But we didn't have approval of central bank corporate into our regulatory capital.

We already got this approval. But this happened in this Fourth Quarter in the month of October. So these represent probably around three points in terms of BASEL index. So you should expect these to impact in the Fourth Quarter.

VaR was 48% of average holder's equity, which is historically low for our standards. So moving to end of shareholder's equities as we always highlight here is exactly the less quarter shareholder's equities, plus the net earnings less dividends eventually distributed.

We didn't distribute it and so we ended the quarter at BRL18.2 billion, which is easy to project as we also highlight shareholder's (that) exactly the progression of our earnings net dividends.

On a 9-month basis, or a year-to-date basis, net income was 20% -- 28% higher than the first nine months of 2013, which is in our view solid in regards to (fine) performance. So Marcelo Kalim will describe the business area by area. But we like very much the development of our franchise and our expectation of continuing to deliver 20% plus return on equity, even with less VaR and in this context of the slow economic activity and the slow capital market activities.

The return on equities was 20% of the KPIs in the nine months were also aligned. The same cost income, the same compensation ratio, 41% and 21% respectively. Also, net margin at 50%, which is more or less extended for us and much better than the industry global standard internationally.

So if you take the shareholder's equities of one year ago, move it from 15.7 to 18.2, which is basically as we highlight the progression of our results less the dividends. Only that. And in line with profits, also (residents) move it significantly up. So the first line years of last year was (4.150) and this year, 5.150.

So it's a reasonable growth in revenues income and shareholder's equities. I think with this introduction, I will let Marcelo Kalim talk on more details by each of the business units. And before that, just highlight that these good results happen through the diversification and development of the franchise business.

Now, we have more business units, more geographies, more client business. And less VaR in the (Moco) section of regulatory capital in this franchise and with the same return on equities and we continue to expect these above 20% return on equities for the next quarter's end use.

So again, with this brief introduction, Kalim, you should go area by area now.

Marcelo Kalim {BIO 16142515 <GO>}

Thanks, Andre. Good afternoon. Good morning, everyone. Thanks for attending this call once again. I think we can move to section 1 of our presentation. On page 7, we have the revenue breakdown by business unit and I would like to highlight here is always what we say about revenue diversification.

And interesting to point out that the diversification is more or less the same on this quarter than it is for the first nine months of this year, which I think shows the stability and maturity of our business lines that we are able to deliver a consistent returns on revenues on a quarterly basis, which is, I think, a quite interesting proposition of our business model.

Then we go area by area. We go to page eight where we have investment banking and here, we reached BRL117 million of revenue for the quarter. It's from a number of viewpoints a normal quarter, probably a little bit lower. But from a quality (inaudible) viewpoint, I think a very good quarter, shows the strength of our franchise.

We have, as Andre said, a very slow scenario for capital markets in Latin America and we're able to generate a good amount of return, focused mainly on financial advisory M&A. And we believe this is going to be the trend probably for the next quarter. We don't see a lot of capital markets activity going forward. But we do see the possibility of having revenues on the same (a little) going forward given our position in the ranks in the Latin American market.

But if you look at the numbers, we are very well positioned specifically in the -- in the volume of transactions in Latin America and Brazil. So we believe we consistently believe in these kinds of results.

On page 9, we have our corporate landing unit and we reached BRL200 million for the quarter, slightly above last quarter. But this quarter we show somewhat growth in our credit portfolio reaching BRL44.9 billion, almost a 10% increase in the quarter, which basically the first of the year.

So because of that, we believe we can start to show somewhat higher profits going forward. The state of the portfolio is pretty good even though every now and then we had some specific provisions like we had this quarter. But even with those provisions, we are able to deliver consistent returns like we had this quarter.

So this shows the maturity and the stability of our business unit. On page 10, we have sales and trading and here, I think we have an excellent quarter. We reached BRL784 million of revenue, which is a very significant number. But more than that, with very strong performance from many of our desks including F.X. and including commodities.

I would like to point out also that at this point, we can say that commodities is an established business, it's on par on the same level of performance that's all of our trade investments including F.X., rates and equities.

So this is a very important part in this part of our business and this also contributes to the growth that we have been experiencing in sales and trading and it is something we believe we can continue to deliver in the next quarter.

Also to highlight here that the market environment, I think, plays to our strength in the sales and trading business, the type of volatility that we are seeing, which is somewhat high volatility. But not extreme one.

I think it's very good the type of business that we do and we believe this is going -- this is continue to be -- will continue to be the environment going forward. So we expect somewhat similar results going forward.

On page 11, we have our asset management business and here, I think the story is exactly what I have been telling in the last quarters. Even though we are seeing a negative inflow of money, negative net new money, which was, again, this quarter, our (inaudible) is like positive growth in assets under management. And this is due for being a particular reason in our core Brazilian markets where we're seeing a lot of outflows from simple products like money market funds where we're seeing inflows on more value-added products like equities and private equity and others.

So even though we are quite stable in assets and their management, we have been expanded the revenue mix or having a better revenue mix. And to emphasize that, I think it's just to compare the revenues that we had in the same quarter last year, which was

BRL223 million with the BRL350 million that we have this quarter, which is almost a 50% increase. And this is a very excellent quarter to compare this because due to seasonality, on this quarter we have mainly management fees accrued, not performance fees.

So here, we are basically comparing management fees. And we can see them from year too that they grew almost 50%. That shows exactly what we have been talking about, which is a much healthy revenue mix emphasizing more value-added products where we will, of course, charge a higher management fee.

And as I said, this is a continue case and hopefully, when we turn the tide on negative net new money and start to have positive, this will accelerate this growth that we are already seeing in revenues.

So we are pretty optimistic with this state of the business. On page 12, we have wealth management, which is more or less the picture we are seeing here that we hope to see in asset management in the future.

It's a business that we also have a better revenue mix at this point than we had in the past and now, we are seeing an increase in net new money. So for the quarter, we had BRL3.2 billion of net new money reaching BRL76.5 billion and that's reflected in BRL101 million revenue for the quarter, which is an increase from last quarter. And as I said once, this trend picks up as we are seeing in a lot of time probably are going to see this type of revenue growth going forward as well.

Finally, on page 13, we have our principal investment scenario and here, again, we have a mixed results. We have positive results on our real estate investments with BRL42 million mainly reflecting depreciation in our share of BR properties.

We have a quality of BRL155 million in merchant banks, which reflects equity pickup on our investments offset by the funding costs on all of our investments. And the news here important the negative news, it's negative results on the global markets, BRL361 million, concentrated on credit strategies. And this was a specific thing, nothing that we believe is going to happen again.

Going forward (inaudible), we had a negative BRL164 million for the whole principal investments in this quarter. Going forward on the presentation, we go to section 2 where we have expenses on page 15. And here, I think the main thing to talk about is the expansion in the expenses on (inaudible) and other going from BRL216 million to BRL259 million.

And although it increases, we do believe that costs are extremely under control. And this growth is explained by two reasons. One, it's exchange rate valuation, roughly 40% of our costs are not reals until you see an increase in that part. But also related to one offs that we don't see happening in the Fourth Quarter or we don't see happening in the same magnitude in the Fourth Quarter.

So although we see an increase in expenses, we believe this is extremely under control. Other also to point out here is that our earnings before tax is extremely stable compared to the last quarter.

What we had different this quarter that reduced our net earnings is a different effective income tax rate, which was extremely low last quarter and now, it's, let's say, more stable, although higher than what we believe will be normal.

So the effective tax rate this quarter was 23.1% compared to 18.5% of the same quarter last year. So -- which will be, in my opinion, a more stable rate. But again, we always say this fluctuates from quarter to quarter. So hopefully on a yearly basis we can reduce that effect and have a more normalized net earnings.

The ratios -- cost income ratios, comp ratios, extremely stable for the quarter and for the year. So this indicates for us that the business is performing as we do expect.

Section 3, we have our balance sheet and total assets on our balance sheets reached BRL204 billion. Two things to talk here about. One, is increase in liquidity. Cash and equivalents went from BRL8.6 billion to BRL11.2 billion and this was a deliberate decision from ourselves to finish the quarter on a more -- with a more liquid balance sheet, if you will, in order to be prepared to advance that could happen in the market like elections in Brazil or more volatility in the last quarter of the year.

And we reached our targets. We have an internal target of having more than BRL10 billion of liquidity. We reached BRL11.2 billion. So we're extremely comfortable with that and we are pleased that we achieved that.

Also, to point out here a new line on our liability side, which is the perpetual bond that we issued in September, 3 points BRL2 billion. I would like to emphasize that this will count as tier I capital.

Although, it hasn't accounted that by the end of September. We received a central bank authorization to account that as capital during the month of October. So in the next quarter, we're going to see all the ratios impacted by that. And we are going to talk a little bit about that in the last statement talking about the BASEL issue.

On page 18, we have our unsecured funding base. We've reached BRL64.8 billion and here, you'll see the perpetual issue again. And we are very pleased to see that we grew our funding base in 36% in the span of one year and pretty much all the types of instruments contributed to that. And we were able to achieve this higher funding base at the same base with the same cost level that we saw on the path, which shows this trend of our distribution of funding.

Finally, on page 19, we have our BASEL ratios and valued risks. Basically BASEL ratio was stable at 16%. As I mentioned, this is not accounting the perpetual tier I that we issued. Once we account for that, the -- that we -- the index would reach approximately 19%. So an increase of 300 basis points. And the explanation for issue on this tier I is to prepare our capital base for the pending acquisition. We are still waiting for regulatory approval of DSI.

So once we incorporate DSI, we expect the ratios to go back to what we believe are normal level, let's say, around 15% or 16%. And we're already prepared for that.

On the daily value risk, reached at 0.48 -- .48% of total assets on average, which is, let's say, a pretty substantially lower than it was in the past. But I believe this is more of a trend of our business.

Even the state of our business and the -- all the franchised areas that we saw perform extremely strong, we believe that probably will be able to run the bank with this lower daily value at risk. And I think this is very good news in the -- in the sense that we'll be able to deliver the same -- deliver the same kind of returns that we are talking about using less market risk.

And I think this is something that we're going to be talking also in the future especially when we incorporate DSI into our group. All right.

That's the end of the presentation and now I think we can open for Q&A. Thank you very much again.

Questions And Answers

Operator

Thank you.

(Operator Instructions)

Our first question comes from Carlos Macedo with Goldman Sachs. Please go ahead.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thank you. Good afternoon, gentlemen. Thanks for the opportunity to ask questions. A couple of questions. First, looking at your corporate lending business, did talk about higher provisions there.

That's something we've seen across all of the larger banks in Brazil. Can you comment a little bit of -- about where these are coming from, what risk you perceive and whether you think this might just be a bump in the road or something that we're going to have to deal with more frequently going forward?

Second, now that you have the DSI acquisition is under way and not concluded yet. But you've had more time to look at the company and try to understand all the different dynamics upon the effective merger, is there anything that you can add in terms of what you expect to do, what kind of profitability you can extract, what kind of cost savings you can put in so that we can get an idea of what kind of profitability to expect from the company once the merger's concluded?

A - Marcelo Kalim {BIO 16142515 <GO>}

Carlos, hi. Here is Marcelo Kalim trying to answer your question about the corporate lending business. We are not seeing anything systemic. As I mentioned, it's just a specific markdown that we saw in the portfolio related to the specific situations.

Again, nothing dramatic or nothing that we say that we are concerned about the outlook of our book. Quite the contrary, we think the book is pretty solid and we're pretty optimistic with the revenues coming from the book and we are quite comfortable with that.

And to the point that we have some specific markdowns and we are able to sustain the level of revenue that we are seeing shows that we are on the right direction of diversification and the quality of the portfolio.

So just to summarize, nothing systemic. Just specific, which we believe is pretty normal in the scenario that we are leaving. And I think Andre probably would like to talk about the DSI. So I'll pass the floor to him.

A - Andre Esteves {BIO 1939152 <GO>}

Just before DSI, I have additional comment Carlos between here and Brazil in the large corporate space where we basically act in terms of corporate lending. When you see low reduction in confidence, you see a deaverage in the corporate sector and the generally asset quality improves, not the opposite.

Of course, economic activity doesn't help the companies. But they generally reduce the investment and deleverage. So as a trend, we don't see deceleration (in portfolios) the opposite. We have also interesting (inaudible) risk that can underperform. But the overall revenue -- of level of revenues is high enough to sustain that and continue to deliver good return on equities on this specific business, which is not only a good business for us in terms of results. But it also generates a lot of intangibles to other business units like investment bank or wealth management or merchant bank.

On the DSI side, we are in-between (signing and closing), as you know. And we are interact to the bank via the integration committee, which is supervised by (Seimen) the risk regulator. And yes, we are excited about both initiatives on the revenue side and on the cost side.

So it's -- we highlighted here in the last quarter, the -- if we could find the opportunities, it's basically this industry, private bank industries migrating from (secretive) to service and we think we are good service providers and we continue -- we do see the setup of the industry still very close to what it used to be.

So we think we can complement the range of products of DSI, improve the quality of conversation with clients. And probably promote optimization. So we are glad to what we see in terms of opportunities. Of course, we can implement that only when we have the view up to advise a different (inaudible).

But we are -- we are -- what we are seeing is in line to our expectations or slightly better. And even without us being there, a very interesting signal, is the net new money is positive in the bank year-to-date as the result of DSI was announced.

So -- which is quite good, right? We are -- of course, we are not managing that. But probably number of internal dynamics; the franchise reflects our ownership of the banks. So we are glad with the transaction.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. So you're saying that you're actually seeing positive trends even before you take over? Is that -- so is there anything new that you could -- well, essentially you already said that there's nothing that you really could add from what you said before.

The transaction, as you said, will expect to be completed First Quarter; is that correct?

A - Andre Esteves {BIO 1939152 <GO>}

Yes. We expect First Quarter. And of course, we don't control regulators' timing. But reasonable. The approvals are moving and they should be. So we need approvals in number of different jurisdictions, of course, the most important of them is Switzerland and Brazil.

But it's moving well. But being realistic needs to be -- should be probably First Quarter of next year.

Q - Carlos Macedo {BIO 15158925 <GO>}

Just as structurally, will it be -- will the DSI be consolidated into Banco BTG Pactual in Brazil or BTG Pactual Holdings? How will the structure actually work out?

A - Andre Esteves {BIO 1939152 <GO>}

At Banco BTG Pactual Brazil. So will be our subsidiary of our bank here.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Perfect. Thank you, Andre. Thank you, Kalim.

A - Andre Esteves {BIO 1939152 <GO>}

Thank you. Thank you, Carlos.

Operator

Thank you. The next question comes from Mario Pierry with Bank of America Merrill Lynch. Please go ahead.

Q - Mario Pierry {BIO 1505554 <GO>}

Hi. Good afternoon. I'd like to ask two questions. The first one on sales and trading. If you can help us or if you can quantify the impact of the commodities desk to the overall results of sales and trading, you mentioned this is a well-established business by now.

If you can, just give us an idea of the breakdown of the revenues by the different desks. The F.X. rates equities and commodities. Also, (stayingin) sales and trading, if you could talk a little bit more about the performance of the equities desk, you mentioned that it was sub-par. But clearly reflecting the environments. But more interested in understanding whether or not you have booked losses related to the follow one of (Oye).

Then I'll ask my second question later.

A - Andre Esteves {BIO 1939152 <GO>}

Yes. Well the overall sales and trading business as Kalim highlighted, the performance is very well in the quarter and very well year-to-date. And we are very glad with that. And commodities is part of that as you said and it's performing quite well.

In a certain way, you can see a change in the level of revenues of sales and trading from three years ago to today or even from last year to today given the maturing of the commodity units. And today, commodities has a same of the other units of sales and trading.

So equities and fixed income and F.X. So the magnitude of what we expect in commodities is the same magnitude that we expect in the other units. Of course, by the nature of the business, some of this business we will perform our outperform on a quarterly basis.

This year, basically -- which is almost linear quarter after quarter, commodity is performing quite well. Fixed income is performing also well. F.X. is performing quite well and equities is performing weakly.

And part of that is related to the level of our stock market and certain underwriting positions that we book and we keep in our books on a transitory basis, also didn't perform.

So this level of idiosyncratic risk affects the sales and trading business. So in situations that you mentioned I included in this general result. So that's a description.

The franchise part of the equity business continues to perform very well. We are basically even with weak market performing well within all Latin America. I would highlight our very strong growth in Columbia. Not only this quarter but the whole year in terms of market share, now we are the number one broker in Columbia and significant market share that we already have in Chile, Peru, Brazil. Also in Mexico, the business is performing well.

So the -- that's our overall, let's say, description on sales and trading.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. I was trying to get a little bit more of the details here basically to understand, like, the commodities as a percentage of the revenues from sales and trading. How should we think about this? Is this, you know...

A - Andre Esteves {BIO 1939152 <GO>}

As -- yes, maybe I was -- I was not clear. Assuming a normalized quarter or year, commodities should have the same level of importance of fixed income and equities, which means 1/3 of the sales and trading business.

As I also said, there will be a year that will be 20% around the year that it will be 50%. But at this stage, we could say that it already has the same importance of fixed income and currencies and equities.

And specifically on these years, commodities and fixed income, outperforming equities. So they are above their 1/3 market share in our sales and trading results of -- and we expect more or less this kind of (Oye) distribution in our -- in our business.

And all the business in sales and trading is (inaudible) specifically or in equities more specifically on mark to market baiting, right?

So you mentioned the (Oye) parts (inaudible) participation that we have. It's part of our sales and trading and, of course, impacted the results of this quarter. So it's daily market in our equities division inside sales and trading.

For next year, we still have less; another leg of certain strategy in commodities maturing. So we don't expect the business changing in terms of magnitude. But I know we like the additional diversification that we still have.

So we implemented certain fiscal trading lines that do help the relative part of the business in the slow part of the business. So commodities being the last moment of consolidation and, as I said, we expect that to be 1/3 of the sales and trading business on a normalized basis.

Also important. And this side more related to fixed income and currencies, we are starting the -- our bank in Chile this month and next year, we'll also have banks in Columbia and Peru. And these basically related to of course corporate lending. But it was well important impact in our sales and trading business on the fixed income side.

So we already are important dealers in Columbia, Peru and Chile. But having a bank there will bust -- it's another step in the growth of the business. So that's, I would say, a more detailed description on where we are in terms of sales and trading.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Andre, let me ask you then a question related then to your revenue mix. As you mentioned on your press release that about 50% of your revenues and of your employees already located outside of Brazil.

If you can, give us the breakdown of what percentage is generated in Latin America and how do you see this mix evolving next year?

A - Andre Esteves {BIO 1939152 <GO>}

I think the next year after the incorporation of DSI, the mix will continue to move towards more international diversification. So in terms of the employees, for example, we will have roughly about 1/3 of the employees only in Brazil. Assuming that an important part of our -- the cost is in Brazil.

So relevant part of our business people is outside Brazil. I would say has to be equally divided between our new wealth management business in Switzerland, London, New York international operations, in our underground Latin America business outside the Brazil. So this international mix, if you want, would be equally distributed among these geographies.

It's also important that in terms of business mix, we are moving clearly in the direction of more franchise linked revenues, (del) market linked revenues.

So we -- as you note this, our VaR has been reduced and we are very glad with these results of even with relatively low volume we have provide -- in weak markets, we are providing 20% plus return on equities.

So -- and we think this is a trend on our business. It's -- it was said before, with big corporation of DSI revenues from an asset management and wealth management will be above 40% of total revenues. This is already through for 2015.

So this is, I think, the most important change in terms of revenue mix. The business in global markets or merchant bank will not change. We continue to see the interest in business for us. But I give them the growth of the franchise and diversification of franchise. They will be less important on a relative basis for the overall composition of profits and revenues.

So that's trends. That's -- you can expect that for not only 2015. But for the next years.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. That was very clear. Since you mentioned this, I was trying to put in perspective the loss of your global markets portfolio of BRL361 million this quarter. I was trying to put this in perspective as to the size of the portfolio in order to understand better.

Is this a big loss or is this just something that should be expected? If you can, help us understand better.

A - Andre Esteves {BIO 1939152 <GO>}

Yes. Yes. As you saw in our presentation, we had four positive quarters in a row of profits in global markets. So it's reasonable that we have a negative quarter each five quarters. So we are -- we are Okay with that especially in a moment of volatility in emerging markets and global markets.

So of course, we know our business we due to have a loss. So we don't like to have losses. But I -- we consider this natural to our business. It's under the minutes that we expect. But I -- what you should expect for the future is smaller impact from global markets and merchant banking and although that this business will continue to exist, probably similar size than today. But on a relative basis in the overall context of our equities and our business mix, they will be less important than they were in the -- in the past.

And in this trend, it's already started, right, where you saw the levels of VaR and the returns on equities are already happening. And it will continue to happen for the next couple of years and we are very glad with that, right?

When you see the growth in revenues in asset management and wealth management and forget the aside for one second, even on our existing business it's very, very interesting because people look at net new money to evaluate asset management. But with this was very important change of mix inside asset management.

You see the revenues from management fees. They grew a lot on a 12-month basis. And if you go on a 24-month basis, it's more than double the management fee level on our asset management.

And the same in wealth management. So we like that much, the trend. DSI will -- acquisition will introduce even more of fuel to this trend. The expectation -- a consolidation of expectation in Latin America, we will also push us into this direction, commodities side sales and trading the same.

So we are glad with this direction of the business mix and probably you should continue to expect relatively low VaR historical (inaudible) and less relevance of these units in the context of the overall business mix that we have.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you very much.

A - Andre Esteves {BIO 1939152 <GO>}

Thank you, Mario.

Operator

(Operator Instructions) Our next question comes from Saul Martinez with J.P. Morgan. Please go ahead.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi. Good afternoon. Just elaborating on the whole point of lower VaRs and the lesser relevance of principle investments in global markets. And my understanding and accounting is that the net revenue for this line -- for this -- for this and every other segment basically amounts to the revenues above and beyond the enumeration of capital invested in the business at (Seliki) or CDI.

Obviously, we don't know the level of capital allocated to global markets specifically. But is it fair to say that if returns are below the (Selik) net revenues negative? And given that you are derisking given that the (Selik) rate is going up and could approach 12% that we could see net revenues for global markets actually being negative for some time?

And I ask that because I think a lot of models are actually factoring in pretty significant increases from very low levels in the next couple of years.

Secondly, private equity, is more of a broad question. I think the biggest pushback or concern investors or market participants generally have or one of the biggest ones is around the private equity portfolio, the transparency, what the concerns about the value quality, whether there are risks, write-down's.

A general question is how do you respond to these concerns and what do you think the investment community should know about your private equity portfolio?

A - Andre Esteves {BIO 1939152 <GO>}

Well let's first start on the global markets. Of course, all the results here are above cost of capital, which is CDI. CDI plus something, we can see the liquid securities by spreads above CDI and liquid securities of CDI.

Basically, the global markets portfolio is ultra liquid secured in the vast majority of it. So it's irrelevant if you are increasing on the risk on risk. So it's a -- the -- we expect the positive results in the next quarter.

And when I said about derisking, means that overall bank, it could consider derisking. But we don't intend to get out of this business is just on a relative basis, relative to asset management, relative to corporate lending, relative to wealth management. The business is reducing because these are the business. They're growing and we don't think they have to increase the capital funding of VaR allocated to this principal investment unit.

So it's not necessarily a reduction in absolute terms even though that we had the reduction in VaRs. So it's not a relative trend. And it's not related with the results and so we expect part of the results in the next quarter.

So of course, we can have negative. But it will not be linked to increase or reducing the size of the portfolio. You can have very neutral VaRs and still have some positive results there.

And as I said, global markets basically ultra liquid securities on mark to market basis. On the private equity portfolio, the nature -- we basically mark our books at cost or equity pickup or when it's a public company.

We markup market price less 20%, which is the specific case of BR Corporates profits and BR (Farmers). So probably if you sell 100% of the portfolio, you have booked earnings of significant amounts in this portfolio.

So that's, let's say, the picture of today. Of course, the nature of this business is you have few investments that will completely outperform, few investments that will be flattish and few investments that probably you'll lose money.

And the secret here is that the outperformance will be number of times capital invested. And the VaR performance will be the loss of your capital invested and the flattish will be basically CDI or inflation or slightly above that.

So that's the dynamic of the portfolio in how we see it's progressing. So we are -- we are glad with the overall results and we don't expect a deviation of this pattern in the next quarters or years.

So what we have in our books, they will deliver overall. More or less trends like that. So we have certain equities pickup assets. We have one of them in (Petru Afica) last quarter where we basically did the equity pickup of a specific CAPEX for oil exploration and the accounting moves that. But it doesn't reflect the low term trend of the investments, which we consider quite good.

So the accounting books are very clear and as I described it and we see the portfolio even in this weak environment behaving like I described it. Few investments are completely outperforming. Some of that was flattish and some investments will not perform.

But the underperformance is much more than those that outperform. You all -- we also use (inaudible) as a liquid provider for certain situations where you can allocate capital on a (control) basis.

So I responded in the Portuguese call one hour ago about few Spanish investments that we did in the -- in the almost the peak of the relative (inaudible) Europe crisis at the end of 2012. And probably you should expect some divestment of these assets now that the situation is normalized.

This is an example of how we like to use commercial bank unit. We have enormous due flow not only Latin America. But, of course, concentrated in Latin America. That permits us on a stronger equity base and strong investment -- investor league, organized club deals where we can be (inaudible) or optimistic or provide certain clients with long-term equities or equity breech.

So we use and intend to use these units with dysfunction. And on a long-term basis, business is very profitable and quite manageable. So I think that's my overall take, Saul, on your question.

Q - Saul Martinez {BIO 5811266 <GO>}

How often do you test for impairment on your private equity portfolio?

A - Andre Esteves {BIO 1939152 <GO>}

On a quarterly basis.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Okay. Thanks very much.

A - Andre Esteves {BIO 1939152 <GO>}

So what you saw, basically we don't markup only on equities pickup or on liquidity events and we test performance on a quarterly basis.

Q - Saul Martinez {BIO 5811266 <GO>}

Great. Thank you very much.

A - Andre Esteves {BIO 1939152 <GO>}

(Somethings) are at cost when nothing happened or we do equity pickup in business when it happens. If we take public, we use the 20% discount or we mark down when we consider impairments.

So that's why I said if we would sell the whole thing, you have probably significant unbooked earnings.

Q - Saul Martinez {BIO 5811266 <GO>}

Got it. Thank you very much.

A - Andre Esteves {BIO 1939152 <GO>}

Okay. Thank you, too.

Operator

(Operator Instructions) Thank you. That brings us to the end of the question and answer session. I will now turn the floor to Mr. Andre Esteves for his closing remarks.

A - Andre Esteves {BIO 1939152 <GO>}

Well thank you all for participating in our call. Expect you guys here again at beginning of January on discussion on the year. And as I said, we continue to see good perspectives and good franchise developing our business.

So very glad with the results and also glad with your participation. Thank you very much.

Operator

Thank you. This does conclude today's presentation. You may now disconnect your lines. Thank you.