Y 2018 Earnings Call

Company Participants

- Joao Marcello Dantas Leite, Executive Officer and Chief Financial Officer
- Roberto Balls Sallouti, Chief Executive Officer

Other Participants

- Jorge Echevarria, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, and welcome to the Fourth Quarter of 2018 Results Conference Call of Banco BTG Pactual. With us today, we have Roberto Sallouti, Joao Dantas, Pedro da Rocha Lima. We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the Bank's presentation. After Banco 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 from February 25th through March 2nd.

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 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 morning. If you could please turn to page three of the presentation, I'd like to start out pointing what are some of the highlights of the fourth quarter results.

Number one, it's important to point out the significant net new money inflows that we had in both our wealth management and our asset management businesses, with assets under management increasing over 35% year-over-year. Second point that is worth mentioning is that we had record revenues for the full year in our Investment Banking division. It's actually the record revenues we've had since we went public in 2012 -- in 2012. Third point worth mentioning is that our retail platform, BTG Pactual Digital, has completed the roll-out of its full platform, with the roll-out of the Home Broker and has been increasing, accelerating its expansion. Now, also accessing the IFA market, the independent financial advisers.

And finally, our Sales & Trading revenues, as we went back to a normal course of business, second and third quarters, we adopted a very conservative approach towards our balance sheet. Because of the global scenario and because of the local elections in Brazil, in the fourth quarter, we went back to normal activities as can be seen by VaR going back to historical levels and also revenues in our Sales & Trading business went back to historical levels.

If you turn now to Page four, we talk about the specific numbers for the quarter. We had revenues of BRL1.55 billion for the quarter with a net income of BRL711 million. This gave us an annualized ROE for the quarter of 15%. If we exclude the amount of capital that is allocated to EFG, the Swiss private bank and to Banco Pan, which is the consumer bank that we have, the ROE for the core business of BTG Pactual was 19%.

For the quarter, our cost income ratio was slightly above historical average, due to one-off expense. We finished the quarter with a cost-income ratio of 52%, and a comp ratio of 29%. And finally, we closed the quarter with total assets on our balance sheet of BRL137.6 billion, a reduction from what we had in the Q3, basically because of trading activities with government bonds. Joao Dantas will comment that a bit more when he talks about each individual business lines, and we also finalized with a Basel ratio of 16.6% and equity of BRL18.8 billion.

In the quarter, we also approved interest on capital of BRL604.5 million. And as I mentioned previously, VaR increased slightly to 49 bps [ph] of average shareholders' equity to BRL93 million.

Turning to Page five. We have some numbers of the full year 2018. We finalized the year with total revenues of BRL5.35 billion and net income of BRL2.74 billion. This gave us an ROE of 14.7% and for our core business of 18.8%. Our cost income ratio for the year was within historical average cost income of 48% and a comp ratio of 24%. As I mentioned previously, we finalized the year with equity of BRL18.8 billion and for the full year, we distributed interest on capital of BRL1.2 billion and bought back in our buyback program approximately BRL320 million, totaling 15.9 million units of BTG Pactual.

If you turn to Page six, you see the distribution among the different business linesas a percentage of revenues. What's probably more interesting here is to observe the full year revenues. We expect in the next upcoming quarters and years for us to see a continuous increase of our client franchise businesses as a percentage of total revenues.

Turning to Page seven, we see the ROE of the different financial institutions that we have under BTG Pactual. So, for both the quarter and the year, EFG had basically flat ROE. Banco Pan had for the quarter 8.5% ROE, and for the year 7.4% ROE, with the core business of BTG Pactual having 19% ROE in the fourth quarter and 18.8% ROE for the full year.

With that, I'll turn the floor over to Joao Dantas, who will comment on each of the individual business lines.

Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Thank you, Roberto. Thanks everyone for joining our call. Before we go area-by-area, just to give a little bit of background, the fourth quarter will be

-- the performance we'll describe for the fourth quarter will be very much in line with what we saw for the whole year, where we had very strong performance on the client franchises, especially Wealth Management and Asset Management, which have been growing assets -- asset gathering in a very fast pace, and also for Investment Banking.

So, starting with Page nine, you'll see Investment Banking revenues have reached BRL86 million in the quarter from BRL58 million during the third quarter of '18. Revenues have been picking up, despite still weak capital market activities in volumes in the fourth quarter of '18, especially equity capital markets we saw a very weak activity during the fourth quarter.

On the other hand, M&A activity is growing and we already see relevant strategic investors that are joining other players in the pursuit of assets in LatAm. We saw for -- more for the beginning of 2018, M&A activity geared towards private equity investors and now more towards the end of the year, we already see more interest from longer-term players, strategic investors looking for acquisitions. In terms of market positioning, our M&A franchise ended the year number one, ECM ended the year number four, but very well positioned in the region.

Going to Page 10, here we see our corporate lending book. On the right part of the page, you see the portfolio that went from BRL26.1 billion to BRL29.7 billion, a growth of BRL3.6 billion, while our revenues reached the BRL133 million for the quarter, the lowest revenues for the year. The portfolio is growing on the back of more active demand for longer-term credit. We have been replacing maturing credit in growing the portfolio with topnotch rating transactions and that demand comes in line with higher level of entrepreneurial confidence that we can already observe in local markets.

The spreads for the new credit are in line with historical levels and we have increased our provisions during the quarter. They have reached 5.2%[ph] of the book and the -- besides the increasing of provisions, we also had a dismal contribution from NPL portfolios in the quarter. Even though the NPL business is growing and performing well, we had almost no events that realized P&L in the quarter for NPL -- for the NPL business.

Going to Page 11. Here we see the performance of Sales & Trading, where revenues reached BRL497 million, above the average for the four quarters of the year and a significant pickup compared to the third quarter of '18. What we've seen in the second and third quarter was that due to the election period, trading volumes and risk appetite in LatAm were weak. After that, especially after the elections in Brazil, what we have been seeing is that risk appetite is resuming and trading volumes are growing again. Therefore, we also increased our VaR relative to the third quarter of '18, from 0.30 bps to 0.49 bps [ph] of our average equity and have deployed more capital in Sales & Trading, despite a reduction in total assets that we will explain when we talk about the balance sheet.

Page 12. We see Asset Management, and here is some of the highlights that we have mentioned before. On the right part of the page, you see the AuM chart where our AuM went from BRL184.2 billion in the end of the third quarter to BRL207.5 billion in the end of the year, comparing to BRL144.9 billion the end of 2017. This is a 43% [ph] in (technical difficulty) in assets under management, propelled by -- especially by a 30% net new money during the year. The total net new money of the year was BRL43.7 billion and this has been a consistent trend throughout 2018, mainly because, number one, of the performance of our LatAm funds, which have been delivering very good results among industry and also because of the macroeconomic conditions where we have been experiencing low levels of inflation and interest rates in their low historical average, which in turn caused investors to look for longer maturities and higher yields, which benefits our asset management platform. So it's a little bit of the same phenomena that we saw throughout LatAm and which we consider a consistent trend, given the current market -- macroeconomic environment.

Turning to Page 13, you see more of that in our Wealth Management performance. On the right chart, you see that our wealth under management reached BRL119.2 billion, which is a 37% growth compared to the end of 2017.

Total net new money for the year to reached BRL23.8 billion, or 27% of our assets in the end of 2017, which is a very accelerated pace of growth, here as well, pushed by the good performance of our Asset Management business, also the growth efforts and initiatives that our Wealth Management platform have been implementing, which have been very successful. So the platform continues to grow in line with the growth of Asset Management. And here also some comments on our digital initiative, as Roberto mentioned, we have completed in the quarter our build-up of the online investment platform that happened actually in the beginning of November of 2018. Now, all the products that are offered in our open Wealth Management platform, which is designed for high net worth and ultra high net worth individuals, have been made available to online clients and that includes the vast majority of fixed income products that are traded in Brazil, over 200 funds managed by more than 110 independent asset management firms, and also the Home Broker platform, which provides access to equity futures in Brazilian Stock Exchange.

And also our clients have access to performing FX transactions in our platform. So all in all, the platform has now completed its development and what we see in consequence of that is that the asset gathering pace for assets in the digital platform has increased significantly from the average of last year and we have been seeing that pace maintaining and expanding, as we continue to attract clients directly in our platform.

Also important to note that since we completed the offering of products in the platform, we have also been engaging independent advisers and also we see asset management growth in the digital platform due to the fact that some independent advisers are already joining our platform. So, very positive performance of the digital business, alongside Wealth Management and Asset Management.

And then turning to Page 14. Here, we have principal investments, where we had revenues of BRL328 million and mostly -- most of that coming from the results of Merchant Banking. Even though we have been decreasing our Merchant Banking portfolio consistently and we'll continue to do so going forward, we have two more relevant assets remaining in the portfolio, which are Eneva, our stake in the power generation company in Brazil and a stake in Petro Africa, the joint venture for oil exploration in the Coast of Nigeria in Africa, and those two assets presented very good performance in the fourth quarter. And besides that we had some positive results from Global Markets and negative results in real state that represent basically the allocation of funding cost without any realization of profits in the period for real estate.

Moving to Section 2, in Page 16, we have some comments on expenses and main efficiency ratios. As you see, our revenues in the fourth quarter of 2018 reached BRL809 million, above the levels of the third quarter of 2018, mainly due to one-off expenses. In the line Administrative and Other, you see that our expenses went from BRL188 million to BRL229 million, basically due to one-off costs -- legal costs.

And also we had an increase in the bonus expenses, because of the higher operating revenues in the fourth quarter. With that our cost-income ratio in the quarter reached 52% and excluding one-off costs, we would have 47% cost-income ratio. For the year, our expenses reached BRL2.5 billion, which is a 48% cost-income ratio and if we exclude the one-off costs, if we normalize for the one-off costs, we would have had 41% cost-income ratio, which is pretty much in line with our historical performance in terms of efficiency. And also important to note, income tax for the quarter ended at 25.4%, effective income tax rate, with BRL188 million of tax expense in the period.

Moving to Page 18, here we have the analysis of the balance sheet and we will explain a little bit the apparent conundrum between more capital deployment with lower assets. But just starting, it's important to highlight that we continue to run a conservative balance sheet. Our total leverage is at 7.3 times our equity, coming from 8 times -- 8.5 times our equity in the end of the third quarter. Our cash represents a 15% of our total assets and due to that our LCR, which is the regulatory measure of liquidity, is at 205%. We should be complying with the minimum of 100% LCR and we are complying with more than double that.

The unsecured funding covers now 230% of our banking book, which is composed mainly of credit instruments and both have similar maturities. The average maturity of liabilities match the average maturity of the banking book. And finally, the total assets variation is represented basically because we carry less repos and reverse repos. In other words, our matched portfolio of assets have reduced. Typically Brazilian banks are intermediaries of liquidity from the asset management industry deployed into the market. So we may have more or less matched portfolio of repos and reverse repos, because of that, and in the quarter, we had a fluctuation down of those assets and those assets don't represent any risk taking or capital deployment in our balance sheet.

Also, we had a reduction in secured funding and trading portfolio of assets, which also represents a very little reduction in terms of risk taking and capital deployment. The capital deployment has increased and the VaR as an average of equity had increased as well, as we will show later in the presentation.

Turning to Page 19. Here is the broader Credit Portfolio. It's growing in line with the corporate lending portfolio. Our broader credit portfolio reached two times our equity, reaching BRL38 billion. Not only we had growth in corporate lending, we also had growth in the Wealth Management and other credits as well during the quarter.

Turning to Page 20. Unsecured funding base has increased little bit from BRL44.8 billion to BRL45.1 billion. We had some maturities in the quarter of some relevance and we had the ability to renew the funding base and has been expanded slightly. While the funding base continues to expand, we see the average cost and average maturity to be stable. Our average cost in terms of percentage of CDI has been stable throughout 2018. And it's important to highlight that during the first quarter of 2019 we had two significant funding events that are public. One is the issuance of a $600 million 10-year maturity, Basel II [ph] compliant Tier 2 bond in international markets that we completed in the beginning of February, and another important milestone, the issuance of a 10-year Tier 2 bond of $100 million through our banking subsidiary in Chile, both (inaudible) a good stance where we see our funding base -- funding relationship counter-parties.

Finally, turning to Page 21, we see here that Basel ratio went down from 17.8% to 16.6%, does not include the Tier 2 issuances that I mentioned before, which will contribute with about 200 basis points increase when they are incorporated to the capital base. And also our average daily trading VaR ended the year as an average of equity during the fourth quarter at 0.49% compared to 0.30% in the third quarter and still slightly below our historical average.

Those were the comments I had for the presentation and now we are available for questions that you may have. Thank you very much.

Questions And Answers

Operator

The floor is now open for questions from investors and analysts. (Operator Instructions) The first question comes from Jorge Echevarria with Morgan Stanley. Please go ahead.

Q - Jorge Echevarria {BIO 20804516 <GO>}

Hi Roberto and Pedro. Congratulations on the good results. So I have a couple of questions. First, on the Sales & Trading business, we saw the VaR picking up to 0.5%, but the historical average around 0.7%, 0.8%. So do you think you could reach these levels during 2019, and what would that mean for your average potential revenue in the business units? And then I'll ask another question after that.

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

Definitely, we could -- we have space within our risk limits to increase those. Unfortunately I cannot assure you that, that automatically translate into revenues. Right. You have to make sure that you are having the -- when market making for clients that you're not run over in -- on the wrong hand of market movements. So, yes, we do expect that this can go back to the 600, 700 [ph] revenue level that we've had in the past quarters and also, yes, we have risk limits that if we think appropriate we can increase the VaR allocated.

Q - Jorge Echevarria {BIO 20804516 <GO>}

Great, thank you very much. Then if you could give us some additional color, maybe on the corporate lending provisions this quarter. Just wanted to understand a little bit better what happened with these clients on the utilities and food and beverage segment. Also how how much provisioned are these companies or these loans, and if you expect to book any further provisions going forward?

A - Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Hi, Jorge, Joao Dantas here. As you know, in Brazil, provisions are a direct function of the rating attributed to the credit transactions, then the ratings can vary due to basically two factors. Time, if the transaction comes to expire and becomes overdue, or the quality of the counterparty. And in our case, during the quarter, we have increased rating, not because of transactions becoming overdue, but because of the perceived quality of the counterparty. So, we don't expect further provisions for the next quarter and we expect, now that the rating -- the credit provision that we have to be adequate to the business that we are going to run. Of course, if conditions change, if conditions of specific counterparties or sectors change, we may re-evaluate that, but it's not something that we anticipate.

Q - Jorge Echevarria {BIO 20804516 <GO>}

Okay, thank you. And one -- maybe a couple of last questions. One on the ECTP loss that you booked this quarter of approximately BRL76 million, can you explain a little bit more what drove the loss on this business?

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

So, if you remember, we spun off the commodities business, maybe a year and a half ago and this is the remainder 20% of what we had of what used to be the commodities division, which is now called ECTP. ECTP had a bad quarter, as can be seen by this result. And this is the reflection of that 20% stake. We expect, hopefully, in 2019 for ECTP to buy back this equity stake and then there would be no more equity pickup in the Bank of the commodities trading business.

Q - Jorge Echevarria {BIO 20804516 <GO>}

Okay, perfect. And then lastly on the digital side. So, you're saying that there is this possibility that maybe regulators could eliminate the rule to -- for you to approach other independent financial advisers and that you are already picking up the volumes -- volume growth in this -- with this agents. But, in general, my understanding is a lot of the new potential independent financial advisers would be coming from the banks. Are you seeing this happening and how many of these do you think you can book in the next year?

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

So, let me answer your question in two phases. The first one is right now we are limited from approaching the current independent financial adviser offices that are affiliated with the market leader that has 80% market share. This was via a temporary judicial measure, which we are convinced that once we are able to explain to the judges exactly what the market conditions are this restriction will not continue anymore. and we also know that all the different regulators, the CVM, the Central Bank, as well as (inaudible) is following this very closely and it's clearly in the best interest of investors that investors have options to move freely, as well as independent financial advisers also have liberty to choose what platform is best for them.

So, this restriction is something that we expect to fall, but it has not -- we have continued growing, probably not as fast as we could, but given the level of satisfaction of both the final clients and of the current financial advisers that we have on our platform, we are seeing -- we are being approached by many financial advisers wishing to change to our platform, and once they approach us, we have no restriction. So growth has continued, we think it can be faster and we expect that the current restriction will not last very long.

The second question is about the structural transformation that is happening in this market and if you follow market numbers every month, you have an increase in the total number of financial advisers in the market, many of them coming from banks and we expect this trend to continue and we also expect that the offices that will be in our platform will also benefit from this. So if you look at the secular trend in the US, if I'm not mistaken, only 10% of investments is in the retail banks. In Brazil, 90% of investments is in retail banks. So, we expect this migration to more specialized complete platforms to continue and for it to be a trend over the next few years.

Q - Jorge Echevarria {BIO 20804516 <GO>}

Okay, perfect. Thank you very much for your answers.

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

Thank you, Jorge.

Operator

The next question comes from Ted Towing [ph] with Kora. Please go ahead.

Q - Unidentified Participant

Hi, thank you very much. Actually, the bulk of my question was -- already been answered, but maybe you guys could continue to talk about how you see guided architecture versus open architecture in the future on your Wealth Management -- or in your Wealth Management business?

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

Thank you, Ted. Well, we currently already have an open architecture and we think that this is -- it's a must. We are seeing the retail bank opening up their architectures, because if not, they will be losing clients and investors through the open platforms and actually, if anything, we think that we need to be number one in the service we offer to the final investors. Number one -- and the number of options that we offer to them -- and number one in making sure we give them the advice in the way that the client wants. Some clients want a lot of advice, others prefer to do it alone and we are developing a model where we are able to tailor to each of the client's desires.

Having said that, we are proud to say that actually we are the platform which has the largest number of asset managers -- third-party asset managers in the platform. So we think this is a trend and we actually want to lead it, because we think that keeping a restricted platform will not last long even for those banks which are trying to do that.

Q - Unidentified Participant

Thanks.

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

Thank you.

Operator

(Operator Instructions) Showing no further questions. 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>}

Thank you, everybody once again for joining our fourth quarter earnings call. I hope to see all of you again in the end of the first quarter. Have a great day.

Operator

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