Q1 2019 Earnings Call

Company Participants

- Joao Marcello Dantas Leite, 'Executive Officer CFO IRO & Member of Board of Executive Officers'
- Roberto Balls Sallouti, 'CEO Member of Management Board & Director'

Other Participants

- Jorge Ignacio Echevarria Gonzalez

Presentation

Operator

Good morning, and welcome to the first quarter of 2019 result conference call of Banco BTG Pactual. With us here today, we have Roberto Sallouti, 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 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, and a platform. There will be a replay facility for this call from May 9, through May 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 prospects of Banco BTG Pactual.

These are merely projections and as such are based exclusively on the expectation, 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. Please go ahead.

Roberto Balls Sallouti {BIO 4150617 <GO>}

Thank you very much, and good morning, or good afternoon, to everybody. If you could please start with Page 3, of the presentation, where we have first quarter highlights of the results. We were very satisfied with the results of the first quarter. It shows a significant strength in all of our client franchises and a continued increase in the return on equity quarter-after-quarter and the same path that we have been having in the last few quarters.

The first point to highlight is that we had a very strong performance in investment banking. This not only came from Brazil, but also from our franchises in the other Latin American countries, specifically Chile, Peru and Columbia. We also continue to grow wealth management very strongly. Well, the assets in our Wealth Management business grew 33.4% year-over-year, so Q1 '18 versus Q1 '19, reaching BRL134 billion.

This is a function of both our traditional asset management business, but also of our digital -- tech-enabled digital franchise, targeting the retail markets. The growth in this business has been accelerating quite strongly. Recently, we have been increasing the number of the registered investment advisers that we are on boarding. We're also making new investments in the platform.

We expect by year-end to offer some transactional banking to ensure our clients a more complete experience in the platform. And with this, we are seeing -- we expect that this strong growth in our Wealth Management continues over the next quarters. Even though we have been investing significantly in technology and marketing, all of these costs have been going directly to expenses. And even so, we have been able to keep our cost-to-income within the historical average.

So, this means that on our traditional businesses all of the IT investments that we have been doing have also allowed us to improve our productivity in the traditional businesses. And finally, the last point to highlight is that Banco Pan reported results yesterday, once again, consistent and with continuous growth. They reported an adjusted return on equity of 21% for Q1, also in big part due to the full digitalization of both the front end and the back end that has been happening there over the last few years. Turning on to Page 4 of the presentation.

We can look at some of the details of the Q1 results. We had total revenues of BRL1.48 billion, and a BRL722 million earnings for the quarter, an adjusted ROAE of 15.1% and net income per unit of $0.83. As I said previously, cost-to-income and comp ratios were within the historical average, 43% and 23%. And finally, we closed the quarter with assets of BRL164.7 billion, a capital ratio of 17.6% and shareholder's equity of BRL19.4 billion.

Moving on to Page 5. You can see the breakdown of the revenues between the different business units, and you can see that it's very evenly spread out among the client franchises. The only one -- the only business area that is still, let's say, higher than the others is Sales & Trading, but this has been decreasing as a percentage of total revenues, and slowly but surely we have been increasing the client franchises, which don't use capital, or the credit business which is more stable. So quarter-over-quarter this has been a trend, and we expect this trend to continue throughout the next quarters and years.

Turning on to Page 6. We show the return on equity of our different financial businesses. It's very easy to know how much regulatory capital is associated to each of our financial businesses. So the core BTG Pactual businesses had a return on equity of 18.7%.

Banco Pan, in our balance sheet, had a return of 10.6% without any adjustments. And EFG had a return of 4.4%. With that, I'll pass on the floor to Joao Dantas, who will be able to talk a bit each of the business lines in more detail.

Joao Marcello Dantas Leite {BIO 17617595 <GO>}

Thank you.

Good afternoon, Roberto. Thanks, to everyone joining the call today. Let's turn to Page 8 where we start with our Investment Banking franchise. As you see, we have reached BRL175 million in revenues in the quarter, and that performance comes essentially from the debt capital markets and M&A transactions.

We continue to see the environment, the business environment improving in Latin America slowly. But in the quarter, ECM activities were very weak, especially in Brazil. Despite the growing appetite for equity assets, we see that growing appetite coming from local investors, not so much yet from international investors. That caused ECM markets to have very little activity, therefore very little revenues.

But this year in revenues were the highest since our IPO, and M&A revenues were the highest in the last 2 years. And that is a strong statement to the quality of our franchise, because M&A is a direct bilateral one-to-one relationship. And as we continue to be leaders in M&A we are also sure that franchise is performing at its best. Turning to Page 9, we have Corporate Lending portfolio.

You see that our portfolio increased from BRL29.7 billion to BRL30.8 billion total credit exposure. Credit lending demand has not yet picked up in Brazil especially. Our Corporate Lending portfolio is now growing more in Chile than it is in Brazil. We believe that this is due to local investors awaiting for a more concrete view on how the reform, especially the pension reform will be approved in Brazil.

And therefore, the growth hasn't been so -- in the quarter hasn't been so accelerated as we saw last year. There is also very small contribution from our special situations portfolio. The business is progressing very well. Special situations is with a lot of activity and launching new initiatives.

But particularly in the quarter, we didn't have any significant contribution to revenues from special situations. And this led to the performance of BRL186 million of revenues. We also have positive outcome in some credits that we've had for which we made provisions in the past, and we were able to release provisions through P&L in the quarter, given the successful turnaround processes that concluded. But then on the other hand, we took advantage of debt to increase further some other provisions in the Corporate Lending portfolio.

So, all in all, it was a wash, but we believe that the quality of the lower loss provision has improved since we have maintained the level of provision, despite the improvement in some specific cases, as I mentioned. Turning to Page 10. Here we have Sales & Trading, where we reached BRL436 million of revenues in the quarter. It's still -- it's at the average of the performance for the year of 2018, still we believe below the average, the historical average for Sales & Trading.

But we did have very good performance from equity, fixed income and FX during the quarter. The only desk where we didn't have a very good performance in the quarter was the energy desk. During the quarter, we increased our VaR as a percentage of equity, we'll mention that in more details further down in the presentation, and we also increased the use of balance sheet during the quarter. We did see stronger flows, despite the market which was more volatile.

We still don't see a lot of presence from international investors in these flows. The flows are stronger from local investors. But we're happy with the results of Sales & Trading in the quarter. Turning to Page 11.

Here we have our Asset Management franchise. The assets under management grew BRL6.6 billion in the quarter, going from BRL207.5 billion to BRL214.1 billion. Net new money was flat. It was a quarter of significant senior management announcements with our new partner that joined us March 18, to run the equities asset management, and our new asset management CEO, who will join us in July 1, Edoardo Guardia.

In an institutional asset management business like ours, it's natural that during the period of management announcements net new money pace slows down. But we already have the new management in place and talking to clients and making the visits, and we are now seeing that the pace is picking up gradually. And we expect that pace to resume, and even further increase, and we expect net new money to continue to be strong, since we see positive performance in our products across LatAm. Revenues of asset management reached BRL167 million, which is in line with the third quarter of 2018, and slowly growing in line with the assets under management growth.

The revenues were smaller in the quarter compared to the fourth quarter of 2018, because typically in the fourth quarter we capture performance fees from our fund mandates, and not typically in the first quarter of '19. Turning to Page 12. Here is the Wealth Management platform, where we had BRL7.4 billion of net new money, moving wealth under management from BRL119.2 million at the end of last year to BRL133.6 million at the end of the first quarter. It's a very significant net new money, very significant performance, and because of that, revenues continue to increase, reaching a new plateau of BRL131 million.

It's important to emphasize that the performance of our core Wealth Management business, we have been delivering great service, we have been delivering good performance. The investments on technology are also helping the wealth management platform, because it helps the interaction with clients. The user experience for clients in wealth management is also increasing with the digital investments. And also, the digital investments are starting to show results in wealth under management.

We have been increasing the pace of onboarding of new clients, both B2C clients and B2B clients that come through independent financial advisers. Not only the pace of the onboarding has increased significantly, but we believe that the quality of the onboarding process continues to be very good. We are dedicating a lot of attention in our teams to deliver great service to our direct clients, and the clients that we acquire through independent financial advisers. Also, if you see the number of downloads of our investment bank apps, they have increased significantly, exponentially.

So, we are very-very happy with the progress of the franchise. We still don't disclose numbers of the digital wealth management clients. They are embedded in the wealth management platform numbers, but we're very happy with the progress. And also, the fact that we onboarded many independent financial advisers in the recent weeks, means that the onboarding of these clients, the process is starting now.

So, we have significant flows to come as the onboarding process continues. On Page 13, we have principal investments, and we reached BRL180 million of revenues, mostly coming from the merchant banking where we had a BRL190 million of revenues, mostly coming from our position in Eneva. Eneva shares are mark-to-market on our balance sheet, and they went from BRL16.09 per share in the last year to BRL18.50. We also have some performance of our investment in Petro Africa, and we do have some performance as well from -- coming from global markets where we have seed money to our global hedge funds.

The negative BRL12 million performance from real state is essentially the allocation of funding cost to the positions. Moving to Page 15. Here we have our expenses and main ratios, and a few things to highlight: our cost-to-income ratio closed the quarter at 43%. The normalized cost-to-income ratio, which excludes one-off items.

Basically the one-off item that we have in the quarter is some legal expenses regarding arbitration and mitigation in Europe. But the adjusted, the normalized ratio is 42%. Basically to compare historically, when we IPO-ed the bank in 2012, our cost-to-income ratio was 45%. And throughout these years we have been increasing the relevance of our franchise revenues and our franchise business through our mix of revenues.

While we have been also taking the cost-to-income ratio down, we would expect that franchise businesses run at a higher marginal cost-to-income ratio than the Sales & Trading and Corporate Lending businesses, which is typically true. But the point here is that digitalization and investments in technology are taking our cost-to-income ratio down, as we grow our franchise businesses. So this is a very interesting, very important side effect of the investments that we are doing. In technology, they are not only helping us grow our new franchise of core asset and mass asset clients, but also helping us operate the bank more efficiently.

Moving to Page 17. Here is the balance sheet analysis and I'll make some important explanations here. First, the -- you see the total assets growing from BRL137.6 billion, which is roughly 6.1 times our equity in the end of last year, to currently BRL164.7 billion, which equates to about 7.2 times assets to equity. This growth, as you see further down, is coming essentially from our portfolio of assets financed through REPOs and our portfolio of trading assets and is totally associated with the growth in volumes from our Sales & Trading franchises we mentioned before.

This is not structural growth. On the contrary, these are flow of transactions that we -- that increased in volume towards the end of the quarter, but that we expect to normalize. So this is not to be viewed as a structural increase in our total assets, even though 7.2 times total assets-to-equity is still -- would still be a conservative asset-to-equity ratio. We also have an increase of our cash position from BRL21.3 billion to BRL22.1 billion.

We have close to our equity in cash basically, which leads to us having a LCR, which is the regulatory measure of liquidity running at 218% average in the quarter, which is extremely a comfortable ratio. So we continue to run the balance sheet very conservatively from a capital and from a liquidity point of view. Moving to Page 18. This is the broader credit portfolio picture, which goes basically in line with our corporate lending portfolio.

The difference from one to the other is essentially the wealth management credit portfolio. And as we said before, the growth of the portfolio with good quality and the same spreads are in line with the history -- historical spreads that we used to capture. Turning to Page 19. Here we have the unsecured funding base analysis, and this is one of the main highlights of the quarter for us.

During the quarter, our unsecured funding base went from BRL45.1 billion to BRL47 billion. We did have some funding renewals during the quarter and we had very strong statements made during the quarter. During the quarter we issued a Tier-II bond in international markets of $600 million, a 10 year note of 5, which was a very successful transaction, a very strong demand from institutional investor, international institutional investors. Very qualified.

The typical names that investing in emerging markets were present in our bond issuance. We also have a Tier-II issuance of $100 million equivalent that we did from our Chilean bank in local currency in Chile in Chilean pesos. $100 million for a 10 year bond that was issued also very -- in a very satisfactory manner. But the biggest highlight for the quarter is the increase in the local funding, the BRL funding.

Bilateral, basically funding in local CDs and local LFs increased a lot. It's a less visible progress that we make, because we don't engage underwriters in that funding space. We fund in our bilateral relationships with our counterparties, so it's less visible. But the growth on the local funding base in reals has been extremely effective and continues to be post quarter.

And all that led to an increase in the average tenor of our abilities by about 13% in the quarter. So we renewed funding with longer dated instruments than the average of the receivables portfolio, which is also positive since we see funding cost decreasing slightly and the tensor of our liabilities increasing, which gives us more -- even more dry powder for -- to capture value in a possible growth of our portfolio, this time a structural growth that we can capture if conditions improve further in Brazil and Latin America. Finally on Page 20, this Basel ratio and our value at risk. Basel ratio is at 17.6%.

This already incorporates the capital, the Tier-II ratios that I mentioned before. Very comfortable levels of capital. VaR as a percentage of equity increased to 0.69% of our average equity, which is pretty much in line with historic averages, and reflective of the bigger usage of balance sheet for Sales & Trading. With that, I conclude the comments that I wanted to share.

And we would like now to open the floor to your questions. And thank you very much for joining our conference. (Question And Answer)

Operator

The floor is now open for questions from investors and analysts. (Operator Instructions) The first question is from Jorge Echevarria of Morgan Stanley.

Please go ahead.

Jorge Ignacio Echevarria Gonzalez {BIO 15186130 <GO>}

Hi. Hello, everyone. Congratulations on the strong results.

So, I have a couple of questions. First, could you provide some color on the banking pipeline for the year? Should we expect maybe a weaker second quarter and then a much stronger second half, if the pension reform is approved? Then my second question would be on trading revenues. Given the higher VaR level and the impact from volatility in energy this quarter, what would be the normalized revenue under this higher level? And lastly, could you provide some more color on BTG digital, maybe the current level of assets under management, number of clients, independent financial advisers? Some more -- a little bit more color on that would be great. Thank you.

Roberto Balls Sallouti {BIO 4150617 <GO>}

Thank you, Jorge. Starting with the first question on investment banking. We're having a strong -- you have three products right, M&A, DCM and ECM What you said is probably true for equity capital markets, especially IPOs. But on follow-ons these have been happening.

We have a -- we have been announcing some quite significant M&A transactions this quarter. So it's very hard to anticipate the seasonality especially because it's hard to anticipate the timing of the closing of the deals. But we are still -- we still believe that this will be a very strong year overall. But I don't want to give you any guidance on quarter-by-quarter seasonality, because sincerely I don't have it.

It's going to be much more dependent on the client than on us. On Sales & Trading, we still continue with what we think average is BRL600 million, some quarters more, some quarters less. But we think -- we still think BRL600 million on average is the normalized rate, BRL600 million is the normalized rate of Sales & Trading. And for BTG digital, investors and analysts always ask us about the number of clients and the number of RIAs.

And we have discussed this a lot and we have essentially decided not to disclose this number, because, while we understand that this might help the equity story of BTG, we also think this will give the wrong incentives to our teams. Because we have to be focused on the experience of the client and of the IRA And if you start focusing on just the number of clients and RIAs, that means that you will be basically jamming your platform with clients that don't also necessarily have the profile that are the clients that we can deliver the adequate resources to give full service. And for us, choosing the right RIAs is very important. Because for the way we see it we're coming from a premium brand and we have to ensure that the same quality which got us here continues when we go on to the retail market.

So we have decided that the best way to show the growth of this business is just show the net new money in total assets under wealth management business. Because at the end of the day this is a -- a wealth management business is a different segmentation. And the truth is, our traditional wealth management business is performing very strongly. But quarter-over-quarter, both the total AUM and the net new money from the digital, the new retail channels are gaining importance.

That's why we're very confident that the strong growth that we've been seeing in the wealth business -- Wealth Management business overall, will continue over the next quarters and years.

Jorge Ignacio Echevarria Gonzalez {BIO 15186130 <GO>}

Perfect. Thank you very much.

Roberto Balls Sallouti {BIO 4150617 <GO>}

Thank you.

Operator

(Operator Instructions) There are no questions at this time. This concludes our question-and-answer session. It brings us to the end of the question-and-answer session. I will now return the floor to Mr.Roberto Sallouti, for closing remarks.

Roberto Balls Sallouti {BIO 4150617 <GO>}

Thank you very much. Thank you all for joining the call. We hope to see you again at the end of the second quarter. Have a great day.

Thank you.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may disconnect your line at this time, and have a nice day.