

Q3 2016 Earnings Call

Company Participants

- Rafael Sperendio, Head of Investor Relations
- Werner Suffert, Chief Financial Officer

Other Participants

- Domingos Falavina, Analyst
- Henrique Navarro, Analyst
- Marcelo Cintra, Analyst
- Thiago Batista, Analyst

Presentation

Operator

Good morning, everyone and thank you for waiting. Welcome to BB Seguridade's Third Quarter 2016 Earnings Conference Call. This event is being recorded and all participants will be in a listen-only mode during the company's presentation. After this, there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions) The presentation is available in the Presentation to the Market section of BB Seguridade's website at www.bancodobrasilseguridade.com.br.

Before proceeding, let me mention that forward-looking statements that may be made during the conference calls regarding expectations, growth estimates, projections and future strategies of BB Seguridade are based on management's current expectations. Projections of future events and financial trends that may affect the business of the Group and do not guarantee future performance, since these projections involve risks and uncertainties that could extrapolate the control of management. For more information on the statements of the company, please check the MD&A.

With us -- with this today are Mr. Werner Suffert, BB Seguridade's CFO; and Mr. Rafael Sperendio, Head of Investor Relations. Please Mr. Sperendio, you may now begin.

Rafael Sperendio {BIO 18963159 <GO>}

Good morning, everyone; and thank you for joining our third quarter conference call. So beginning our presentation on page three, we have here the highlights of the quarter. So the net income of 988 million remaining flat year-over-year, still impacted by the changes in tax rates that we had in both the social contribution in the income tax rate as well as the tax expenses at the broker, which still (inaudible) in the quarter is not directly comparable,

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but if we were to exclude these changes in tax rates, the net income would have grown by 3.1% year-over-year.

The next highlight that we have is our performance in the life, mortgage life and rural, the SH1. Net income dropped by 4.8% year-over-year impacted by higher loss ratio in the term life and in credit life. I'm going to cover even more deep details going forward. But the main highlight this quarter for this business line was the launch of the new term life portfolio, which largely contributed to the growth of 26% year-over-year in premiums written in term life insurance when we look from this quarter on a year-over-year basis.

The next segment in P&C is our SH2. Net income fell 55% due to weaker net investment income and a higher loss ratio, mainly in car insurance. In pension plans, this was the -- our main highlight so far in the quarter. So contributions grew 30% year-over-year. The redemption rates dropped by 140 bps. And when we look at both these factors, the outcome was a growth of 28% in net inflows, which is equivalent to 46% of the total net inflows in the Brazilian pension plans industry. And the total AUM reached a BRL183 billion with an increase of 32% over the last 12 months.

For premium bonds, the net income grew by 48%. It's still favored by the higher spread this year and in this segment specifically, I would like to highlight that we launched a new portfolio for medium-to-high income clients in Banco do Brasil, what we the so called Estilo segment. So we developed this new portfolio. It still don't have a bigger impact in the quarter, as we had the banks strike over September, but we do believe that's going to be very helpful over the fourth quarter to help us to see a kind of rebound in the growth rate for the top-line in this company.

And finally, at the broker, brokerage revenues amounted to BRL672 million this quarter, a growth of nearly 9% year-over-year, as a result of the strong performance in the term life and in pension plans, as I've mentioned previously.

Moving to page four, we have a brief summary of our P&L in the quarter. The net income remained at flat on a recurring basis with the non-interest operating result dropping by 3%, as a result of this -- the higher loss ratio over the life and credit life segments as well as in auto and at the reinsurance company IRB, which was affected by the higher frequency of claims this year in crop insurance, explained mainly by the El Nino effects, which was the strongest one over the last 10 years.

And financial results, which rose nearly 8% year-over-year, which I'm going to cover on next page, page five. Financial result this quarter was positively impacted by a slightly higher average selling rate and by the downward shift movement of the forward yield curve. The yellow lines here as you can see in both the charts on the top of the slide. On the other hand, the lower inflation index, as you may see on the bottom left hand side was negatively impacted the accrual of inflation-protected securities classified as held to maturity, mainly the pension plans company and premium bond.

So what we can see that we have two factors helping the growth in the financial result, while a drop in inflation is only met [ph] in the third quarter as compared to the same

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period last year. And the final outcome was the growth of 7% in the financial results year-over-year accounting for nearly 29% of the net income from BB Seguridade.

On page six, we have here the performance in premiums, in life, mortgage life, in rural, our SHI. In term life, we have the main highlight, as I've mentioned in the beginning in the presentation. Premiums written for term life grew 26% year-over-year. It was helped by the new portfolio with improved recovery rates. And just to give you some more color on its performance, the new portfolio accounted for nearly 19% of the sales in the quarter. So year-to-date, the growth rate in this line accelerated from 10%, as we have in year-to-date June to 16% year-to-date September.

In credit life, premiums dropped by 50% year-over-year, 48% year-to-date. It's still impacted by the challenging environment for credits this year in the country. And in rural, we got premiums dropped by 33% year-over-year, but this was already expected noting that this year there was a higher concentration crop insurance in the first semester due to the early release of working capital loans for farmers, while in 2015, the loan granting period was concentrated in the third quarter, as well as insurance premiums. So when we look to the year-to-date figures, where rural premiums grew by 18% what we considered much more reasonable growth rate for this year.

On page seven, we can see the operating performance of this business segment. So in this quarter, the combined ratio worsened by 5 percentage points, as a result of the increased loss ratio, meaning in the term life and credit life. And this was a result of higher frequency of claims and in this number of claims, we had some claims with a high coverage insurance policies as well as what we call here some claims related to some accidental death, in these cases we have special indemnities that impacted the claims expenses over a quarter that's why it increased by nearly 600 bps year-over-year.

But on the other hand, when we look at the commission ratio, it remained stable with G&A ratio showing an improvement. But it wasn't enough to offset totally the increase in losses, that's why the combined ratio worsened in the third quarter year-over-year and this is explained on page eight, when we look at the underwriting result, it dropped by 6% year-over-year, partially offset by the increase of 3% in the net investment income. But the net income of this business segment is still dropping 5% year-over-year that in addition to the impact in the loss ratio, we had an increase in the social contribution, this explains the 5% drop in the net income for the business segment, but it's still a very strong return on equity 48%.

On page nine, we have the dynamics of sales for P&C, so auto insurance premiums dropped by 26% year-over-year. It was a result of the still tough environment that we have and with a reduction of 20% in sales of brand new cars affecting the addressable fleet. So this was the main impact that we have in the -- in the competitive environment for auto insurance in Brazil. In addition to the fact that when we look at the bancassurance channel last year, we sold many multi-annual insurance policies. So this is natural that over 2016, we do not need to renew as they were at least two-year insurance policies, so this is affecting the performance of the bancassurance channel in addition to the drop in the sales of brand new cars.

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On next page, in the operating performance as compared to the third quarter of 2015, the combined ratio worsened by 200 bps this quarter. This was also a result of higher loss ratio mainly in the auto insurance segment due to higher frequency of robbery and theft and which was partially offset by the marginal reduction in the commission ratio; and by the improvement in the G&A ratio year-over-year.

On next page, we can observe that due to the increase in the loss ratio and consequently in the combined ratio, the underwriting result was negative BRL41 million in the quarter. In addition to the dropping of 33% in the net investment income resulted in the drop of 55% in the net income for the company year-over-year.

Page 12, moving to pension plans. Now, this segment has been showing such an amazing performance this year, so when we analyze the third quarter of 2016 as compared to the same period last year, contributions grew by 30% year-over-year to BRL10 billion. Redemption rate was down a 140 bps achieving 7.8% of the assets under management on annualized basis in this quarter; and the outcome was a net inflow of BRL6 billion, which is 28% up year-over-year.

And when we look at the assets under management the total AUM reached BRL183 billion, 32% higher in 12 months [ph]. So the out -- final outcome of these dynamics of inflows was the increase of 25% in management fee with the average fee charged following the downward path already expected that's 1 bps to 2 bps drop per quarter due to sales mix more concentrated in high net worthy individuals along with the decrease of share of traditional plans in the mix of the assets under management. So when we look at this performance in management fees, in addition to the very strict cost control policy and very positive cost to income ratio for this business, the net income grew by 25% and delivered an return on equity of 43% for the third quarter.

In premium bonds on next page, collections dropped 1% year-over-year. And here as I said before, we launched a new portfolio of products in August, but the effect did not show up in quarter due to the bank strike, which began in September, but we do believe that we're going to have a very good performance in the fourth quarter to improve this minus 16% rate year-to-date. Already improved [ph] when we look at the June year-to-date was nearly minus 20, improved to minus 15 [ph], but we expect that can do even better in the fourth quarter.

The net investment income maintained the excellent performance we have been seeing throughout this year with an increase of 142% and spread as twice as higher than the one that we had in the same period of 2015. So this strong performance in financial result led to the 48% growth in net income year-over-year even in an environment with higher income tax rate.

And here on page 14, we have our brokerage business. So commissions grew by 9% year-over-over this quarter driven mainly by the strong performance that I've mentioned in term life and in pension plans with a contraction in net margin basically due to the rise in PIS and COFINS tax rates, which led to the increase of 5% in the net income year-over-year this quarter.

And finally on page 15, we have our guidance for net income growth in 2016. It ranges from 4% to 8%. Year-to-date, we have reached an increase of 3.4% likely below the guidance. And here the main reasons for the deviation are the higher than expected claims in credit life, rural and in auto insurance, as I covered in the presentation. And it's worth remembering that for rural; we see higher claims impacted both SHI and the reinsurance company, IRB.

And the second reason for the deviation, considering the revised guidance for the year was the weaker than expected sales in this quarter, which was the outcome of the bank strike, which began earlier this year as compared to 2015. So this year, it was concentrated in the September, while last year, it was more concentrated in October. Anyway, we believe that the guidance is still feasible, so we expect that the net income growth will converge to the guidance throughout the fourth quarter. It's not an easy task, but we believe that it's feasible.

So -- and when we look at the fourth quarter, it's worth mentioning that it's going to be the first time that we will have the same comparable basis for the social contribution in the insurance companies. So this is going to be very helpful to increase the growth rate in the net income over this quarter. Although it's still not fair comparable basis for PIS and COFINS tax rate at a broker, but it helps a lot.

So thank you. And now, Werner and I are available to answer any questions that you may have.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Marcelo Cintra with Goldman Sachs.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Hi, good morning, everyone. Thank you for the call. Actually, I have two questions. The first one is regarding the loss ratio in Life segment, specifically. This quarter, we saw a significant increase quarter-over-quarter and also year-over-year, while you also had this new product, which as you mentioned represented 19% of your total sales. So my question here is if these new product, it's maybe a higher loss ratio product and if we should expect loss ratio to remain at high levels going forward or if this was a specific for - this was relate to specific reason for this quarter and we should have the claims dropping to more normalized levels? And then I'll follow-up for second question. Thank you.

A - Rafael Sperendio {BIO 18963159 <GO>}

Hi, Marcelo. This is Rafael. Thank you for the question. So regarding the increase in the loss ratio in the Life segment, it's not related to the new portfolio. What we had in the third quarter this year was increase in the frequency of claims. And out of these claims

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reported in the quarter, we had high participation of claims related to accidental death. When we have such a type of claims in these cases, normally the indemnity can reach up to twice the regular indemnity that a client could have in case he dies for any kind of any other reason. So these was the impacts that we had in the third quarter this year; and we do believe that it wasn't one-off in both claims, in term life and in credit life. We believe that in the fourth quarter, we are going to see a downward trend in this ratio that we simply believe that this is not the normalized level that we expect for this portfolio.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Okay. Thank you for the clarification. And my second question is it's actually a follow-up on your comments on the auto insurance. You mentioned that it dropped the premiums because last year you were selling like the annual insurance product, but when we look at the auto fleet, it's also dropping consistently over and over in the past maybe four quarters or five quarters.

So I'd just like to better understand if -- what should we expect for -- in terms of this trend going forward, if the auto fleet should remain under pressure if this is regarding maybe a more competitive landscape or if it's related to a more challenging industry and it's something that we should only see a rebound next year? Thanks.

A - Rafael Sperendio {BIO 18963159 <GO>}

Regarding the performance in the auto insurance, it's worth mentioning that when -- in the presentation, I talked about the -- in the case of -- the sales of the multi-annual insurance, it was an additional effect in the bancassurance channel, but the main one was the effect that I mentioned earlier about the drop of 9 -- nearly 19% to 20% in the sales of brand new cars, so this is affecting the addressable market for auto insurance in Brazil.

And when we look in terms of the loss ratio, this hasn't been so healthy in terms of the performance of this business line. And as it is not a core business for BB Seguridade, we still are working with the product, but we are more selective in terms of the risk. We are working in trying to be more severe in terms of accepting such types -- some types of cars, motorcycles. And so besides being very strict on the types of vehicles that we have been accepting, we are also working very hard in terms of selecting the types of risk then when we look in terms of the client profile there we want to accept in the insurance company. So this is the effort that we have been doing. We are less concerned with the top line growth. We are more concerned now with the combined ratio of this business. So this is main [ph] focus now.

So -- and we don't believe, unless we see a big recovery in the economic activity and decreasing level of robbery and theft and increasing sales of brand new cars, it's hard to believe that we are going to see any major rebound in sales in this business line, but we expect at least a stabilization in the loss ratio for this business going forward.

Q - Marcelo Cintra {BIO 16463628 <GO>}

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

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A - Rafael Sperendio {BIO 18963159 <GO>}

Thank you.

Operator

Our next question comes from Thiago Batista with Itau BBA.

Q - Thiago Batista {BIO 15398695 <GO>}

Yeah, thanks for the opportunity Werner and Rafael. I have two questions. The first one is a follow-up on an answer you gave in the Portuguese call about the impact of lower Selic rate in the BB Seguridade earnings. Could you share with us again your back of envelope equation of the impact of -- on the BB Seguridade earnings of a lower Selic rate?

And the second one is about the pension business. BB Seguridade has been able to maintain a market share of almost 40% of the inflows or the contributions in the last two years or three years; and this 40% is really well above Banco do Brasil market share in most of the segments. Do you believe that you plan [ph] or BB Seguridade will be able to maintain this level of market share in the coming years?

A - Rafael Sperendio {BIO 18963159 <GO>}

Thiago, this is Rafael. Thank you for the question. So regarding the first one when we look at the impact of the drop in the Selic rate. It's worth to -- I can say a kind of disclaimer that it's hard to find the real impact going forward because there are lots of moving parts here, we have the change in volumes, the change in the forward yield curve, the change in the inflation; and some of them they have a strong [ph] correlation between each other. But what we have when we even disclosed it on the table 10; and this is my back of the envelope calculation if we -- all the floating -- right, this is -- if you look at table 10, this is already weighed by our participation in each -- our economic stake in each affiliate company and the controlled companies here. But in here, in this table, you can see if you add all the floating portion of the portfolio that has impact in the P&L. So excluding the available for sale portion, we are going to reach a total balance of nearly BRL5.8 billion that is our exposure to floating rates. So if we take this balance and apply a 100 bps cut in the interest rate, the net impact should be around BRL32 million. This is the calculation that we have made here just to give you some more color from this impact.

Regarding the pension performance, Werner will give you the answer.

A - Werner Suffert {BIO 18657101 <GO>}

Thiago, regarding this pension business growth going forward for 2017 on, we're still -- if you are going to increase the penetration inside Banco do Brasil client base, it's important to mention that till now a good part of the effort is linked to the high-networthy clients from Banco do Brasil. So if you have room to increase in the Estilo client base or the second tier of Banco do Brasil client base, where the penetration is still very low; and where we have clients with profile to have this kind of products.

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So if you have room to increase and to sustain the same level of contributions, new contributions and adding new clients to this pension plan products. And of course, we will remain trying to have new investments from our current client base. So this will help us to continue to have a strong increase in reserves and contributions in pension plans for the next years.

Q - Thiago Batista {BIO 15398695 <GO>}

Okay. Just one very small follow-up. The BRL32 million is annual and BB Seguridade [ph] in net of tax, correct?

A - Werner Suffert {BIO 18657101 <GO>}

Yes, that's correct.

Q - Thiago Batista {BIO 15398695 <GO>}

Okay. Okay. Thank you, Rafael. Thank you, Werner.

A - Rafael Sperendio {BIO 18963159 <GO>}

Thank you.

Operator

Our next question comes from Domingos Falavina with JP Morgan.

Q - Domingos Falavina {BIO 16313407 <GO>}

Hi, thank you all also for taking the question. I know you're not officially providing guidance for growth in SHI, but what's your mind around the decelerating loan growth of the parent company? And how that should impact credit life? Are we seeing a bottom in this year, should we expect some growth and also term life?

A - Rafael Sperendio {BIO 18963159 <GO>}

Hi, Domingos, this is Rafael. So of course I try to be -- we cannot have a formal guidance for 2017. But when we look at the performance in credit life first of all, we can see that the 50% drop this year has been impacted by, first of all, a comparable basis, so when we look at 2015, the scenario was completely different and we were increasing the addressable market for the credit life insurance within SHI.

When we look at 2016, we do not have much room to launch new products. We're still working with the same basis and due to -- as we have mentioned due to the challenging environment for loan growth over this year, it has been very difficult to keep the same pace that we were reaching until 2015. But from now on in 2017, we will have at least the same comparable basis.

So it will be much, I would say, easier to deliver a better performance as compared to the previous year than we had in 2016. But to see a real rebound in this line, we need to wait

until the economic activity improves; and we see the increasing appetite for growth in credit mainly in our parent company, but we need to wait until they finalize their budget for next year. But from our point of view, when we look in our performance, we will be helped by at least a similar comparable basis that's why we believe that 2017 should be a better year for credit life than it was in 2016.

Q - Domingos Falavina {BIO 16313407 <GO>}

Okay. So it's fair to assume like something on the positive territory at least, not like shrinkage?

A - Rafael Sperendio {BIO 18963159 <GO>}

Yeah, it is possible, but a marginal increase. It's hard to believe that it's going to be very material, but a much better performance than this year. But 2018, then we expect that should be a much better year, then we believe that we will see a rebound should it normalize at levels that we were used to deliver in the past years.

Q - Domingos Falavina {BIO 16313407 <GO>}

Perfect. And what about term -- the regular standard life, term life. Do you have any forecast on that on growth or flat?

A - Rafael Sperendio {BIO 18963159 <GO>}

Yeah. Well, we cannot see, as we don't have i.e., the formal guidance for next year, I cannot give you a number. But anyway, when we consider the performance of the new portfolio in this third quarter and the acceptance of the product when we look at the client's point of view, we estimate that we will have a very good year for this line in 2017. And you can expect better life and pension will remain as the main focus for BB Seguridade in 2017. This is our forecast for next year.

Q - Domingos Falavina {BIO 16313407 <GO>}

Understood. Thank you very much. (inaudible).

A - Rafael Sperendio {BIO 18963159 <GO>}

Thank you.

Operator

Our next question comes from Henrique Navarro with Santander Bank.

Q - Henrique Navarro {BIO 16188960 <GO>}

Hi, everyone. I would like to know if there is any room for expanding commission fees that are paid to the Corretora? I would like to know if there is any recent change in the level of commissions, recently? And if you could also remember us how this works -- I mean, I understand that this is regulated by the contract you have with Banco do Brasil, but in the case you want to increase commissions, which shouldn't be a problem for BB Seguridade,

if the contracts regulated increases in commissions as well or they only present a decrease in commissions? Thank you.

A - Werner Suffert {BIO 18657101 <GO>}

Thank you, Navarro. Well, this commissions they are in an agreement that with the insurance companies they have with the broker. So commissions are paid to BB Corretora, not to Banco do Brasil. So when we have a new portfolio being added or new product being added this of course, we will have discussions around the level of commission that we have in that product. And most of the time because we are talking -- we are dealing with the premium channel, we are able to have a premium of -- a premium commission there; and the new products that we are launching in all these companies, they are -- they have premium commissions at the same level say that we will see in company -- in bancassurance channels across the industry.

So if you look other players -- at our peers that they have operations in bancassurance channels. They also receive this higher commissions because the level and the quality of this client base. So the margins that this companies -- insurance companies they have risk clients that comes from this client base are higher; and we are able to charge better commissions. So these new products that we have, we discuss with our partners in this -- in insurance companies, but most of the time, we are able to increase the commissions to a better level and in doing this, of course, it increases the profitability of this portfolio in our -- in BB Seguridade point of view because we have 100% of the Corretora.

And at the same time, we have an effort to reduce the costs of the reimbursement for Banco do Brasil. So we will reimburse costs related to the sales of these new products, but with the new technology being added, we are able to reduce the time consumed inside each of these branches to sell our products. And we have some benefits from this higher level of efficiency inside Banco do Brasil branches. So lower cost inside the operation with higher commissions provides a scenario, where the broker will remain very profitable in the future even if the higher or higher taxes being paid by this business.

Q - Henrique Navarro {BIO 16188960 <GO>}

Okay. Very clear. Thank you.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I'd like to invite Mr. Rafael Sperendio to proceed with his closing statements. Please Mr. Sperendio, go ahead.

A - Rafael Sperendio {BIO 18963159 <GO>}

I would like to thank you all for participating in our third quarter conference call and to reinforce the solid performance that the company has been able to deliver, despite the challenging environment and to reaffirm our commitment with the 2016 guidance, we are building the P&L for 2017, given the focus that we have been implementing on the most profitable business line. So thank you all; and have a good day.

Operator

With this, we conclude BB Seguridade's conference call for today. As a reminder, the materials used in this conference call is available on BB Seguridade's Investor Relations website. Thank you very much for your participation and have a nice day. You may now disconnect.

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