Y 2017 Earnings Call

Company Participants

- Rafael Sperendio, Head of Investor Relations

Other Participants

- Lucas Lopes, Analyst
- Thiago Batista, Analyst

Presentation

Operator

Good morning, everyone, and thank you for waiting. Welcome to BB Seguridade's Fourth Quarter 2017 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 Financial Information Presentation section of BB Seguridade's IR website at www.bbseguridaderi.com.br.

Before proceeding, let me mention that forward-looking statements that may be made during the company's conference call 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 on the MD&A.

With us 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 earnings call.

So, let's start on page three, where we have the main highlights of the fourth quarter. Recurring net income reached BRL941 million, which is equivalent to a return on equity of 42%. Year-on-year, net income was down 12.5% and dragged by lower financial results. In addition, here to the decrease that we're having in the non-interest operating results, which was driven by higher G&A at insurance companies in SH1 and SH2 I am going to go over it in more details on the next pages.

On the flip side, besides increase in G&A, we could see in both companies SH1 and SH2 some improvements in the loss ratio, mainly at SH1, driven by life and credit life. In the pension segment, pension kept doing well with a net income arising from this segment amounting to a growth of 4.5% year-on-year with a redemption ratio declining 2 percentage points, pretty much close to its lowest historical levels where likely the pension, assets under management to grow roughly 19% in 12 months.

On the brokerage side, revenues were up 3.7% year-on-year, and help us (inaudible) sales performance in credit life and in rural. And on the commercial performance, I would like to highlight here the strong recovery that we managed to reach in the second half of the year. So, when we analyse the main business lines and comparative performance in the second half versus the performance that we delivered in the first half, we can see that -- when we look on a combined basis, premiums grew roughly 15%. The collections at Brasilcap increasing by 58%, contributions for pension plans grew nearly 15%, and also premiums written in SH1 growing 15%. So a very strong recovery in the second half, despite a more volatile environment in the first half of the year.

And finally on dividends, our Board have approved the distribution of 1.9 billion in dividends, which is equivalent to 90% of the accounting net income in the second half. So, considering these amount in addition to SH1 where we have distributed regarding the first half of 2017. We paid out nearly 85% of the accounting net income, which is equivalent to a growth of 4.4% as compared to the amount that we have distributed in 2016. So, despite the increase of only 0.9% in the accounting net income, dividends grew at 4.4%.

On page four, we have the breakdown of the one-off items. So in the 4Q, the one-off items that are up to BRL33 million. So to provide you some color on it, the first one was related to the write-down of the commissions receivable at the broker. So, we're doing the process of the point ERP system within BB Seguridade, BB Seguros and BB Corretora. We're realizing that.

We have to write-off 15 million, actually paying 6 million in brokerage commissions receivable. In the end, other effect was BRL17 million prospectus regarding the revision of the reinsurance operations database at SH2, in order to comply with the SUSEP, the insurance regulator in Brazil, the rules of the SUSEP. So both adjustments were non-recurring, and we don't expect it to happen again going forward. So the accounting net income in the 4Q was 908 million, down 7.5% adjusted by non-recurring event. The recurring net income was down 12.5%.

For the full-year, added to these three effects that I mentioned, we also had the disposal of part of our investment at IRB, which amounted to 171 million post taxes. And when we look at the accounting net income for the full-year, it was up 0.9%, adjusted by non-recurring events, down 4.8%, with a return on equity of nearly 46% on a recurring basis.

On page five, we have the biggest challenge that we had in 2017 financial results. So, our financial results declined by 12% in 2017 and accounted for 28% of the net income, down from 31% in 2016. So, the most straightforward impact of that comes from the reduction in SELIC rate. As you can see on your upper left-hand side, down from 14% to 10% average rate for the year, 7.25% year-end. Inflation was also down on both indexes, IPCA and IGP-M, which impacted the return on inflation protected securities classified as held to maturity.

And on the positive side, we had some movements that helped somewhat to offset these negative effect of a lower Selic and lower inflation of our financial results. So, regarding the lower inflation, the lower IGP-M helped the financial expenses at Brasilprev, so they were lower on the final benefit plans.

And on your upper right hand side, we had the downward move of the forward yield curve in 2017, which provided some gains on mark-to-market of zero coupon bonds. So these factors helped, but were not enough to fully offset basically the decline in the Selic rate, and that's why financial results were down 12% on a yearly basis.

On page six, I'm going to start to cover the performance of third business segment. So, starting with SH1, life and rural, premiums written were up 13% year-on-year in the fourth quarter. In 2017, premiums grew 4.1% and then both comparisons with premium growth was driven by rural, credit life and, to the lesser extent mortgage life. So Credit Life showed a very impressive performance in the second half, so just to remind you, year-to-date June credit life was down roughly 30%. So in the second half credit life grew nearly 60% year-over-year, and that 2017 growing 12% on lower cancellation and also improving origination, mainly in the individual segments, the individuals portfolio grew 28% year-on-year in 2017.

Moving to the operational performance on page seven, the loss ratio showed a very strong trend throughout 2017, despite the uptick in the third quarter, and at the year down 2.6 percentage points. But despite this improvement in the loss ratio, we have observed some deterioration in the combined ratio, mainly in the third and fourth quarter, which was driven by the other two reliable figures.

So, the increase in commission ratio, which was a result of the adjustments that we have made on commissions of some life insurance products sold in bancassurance channel as a commercial incentive for the second half, but actually this is very good for BB Seguridade, despite increasing the expenses at the insurance company, it provides more commissions to the brokers. So on a combined basis, this is a positive effect for BB Seguridade.

And the second variable, here we can see the increase in the G&A ratio, mainly in the 4Q due to the impairment of nearly BRL30 million regarding recoverable reinsured claims. This was the result of the process of revising the database of reinsured operations we started in the fourth quarter 2017.

And the second effect that we had which led to an increase in G&A ratio was related to higher tax expenses which were unusually lower in the fourth quarter 2016, mainly due to the change in the accounting methodology, which we resulted here in the operational deferred tax assets related to temporary differences of PIS and COFINS tax rates.

On page number eight, we can see that despite the increase in commissions, the underwriting result manages to grow 1% year-over-year in the 4Q, and declined only 1% in 2017. Thanks to the lower loss ratio.

Financial results were up 44% year-on-year in the 4Q and driven by capital gains on the disposal of some securities that will -- had been shared at book value in the balance sheet of some insurance companies using SH1. On an yearly basis, financial results here were down 8% and mainly impacted by the reduction in the Selic rate. And as an outcome of what we have disclosed specially in these three pages, net income was down 15% year-on-year in the 4Q and 10% on an yearly basis, with a return on equity of 42% in 2017.

On P&C, page nine, premiums written were down 4.2% year-on-year, 2.2% in the yearly comparison here, and dragged down by auto insurance and DPVAT, which is a mandatory insurance in Brazil. So the government reduced the price of these mandatory insurance because of lower claims and this had a direct impact on premiums.

2017 was still a very good year for household and P&C overall. But it's worth mentioning that according to the announcement that we made earlier this month, we are working together with market in order to redesign the business that we have together, and we are pretty much sure that we will find the best solution for both partners.

On page 10, we have the operating performance at the P&C business. So on the upper left hand side, we have the loss ratio. We actually improved in both comparables in the 4Q prior [ph] year and 4Q in 2017 driven mainly by lower claims in casualties. The commission ratio was up and mainly on the higher commissions paid to independent brokers were auto insurance, so differently from that sequence [ph]. This is not a group trend, but because this commission flows to independent brokers.

G&A also increased 1.1 percentage points year-on-year and 2.1 percentage points in 2017, basically because of the same reasons that we talk about in SH1 related to the change in the accounting methodology for tax expenses. And in addition to that, we also have some higher impairments related to receivables and unrecoverable claims. And as the outcome of these dynamics of lower loss ratio but on the other hand, higher G&A and commissions, the combined ratio will be accelerated by 1.7 percentage points year-over-year in 4Q and 1.8 percentage points in 2017.

On next page, we can see that our lower loss ratio was not enough to offset the increase in commissions, so the underwriting result was down 8% year-on-year in the 4Q and down 6% in the yearly comparison. The net investment income financial results as expected were down 20% year-on-year and 36% in 2017. This is totally explained by the lower Selic rate. So when we add the increase in the G&A ratio to these analysis, we can see that all these effects combined led SH2 to a net loss of BRL59 million in the 4Q and a net income of BRL16 million in 2017.

On page -- page on trend here, page 12, gross deposit has dropped 26% year-on-year. And it's worth reminding that the 4Q reached the all-time high in terms of gross deposits, on the very hard comparables. Even though we posted a decline year-on-year, we managed to sustain the market share which was above a third of the market's gross deposits, which is the ones -- like the ones that we have been able to capture throughout 2017.

So the redemption ratio here kept declining throughout the year, and ended the 4Q at 2 percentage points down year-on-year. And when we look on a yearly basis, the redemption ratio was down 0.9 percentage point, and helped reserves to grow 19% (inaudible) reaching BRL235 billion.

Revenues with management fees increased 16% year-on-year in the 4Q and 22% in 2017. And when we add to these increasing revenues with management fees, the improvement that we saw in the cost to income ratio, these were the main drivers for the 5% growth year-on-year of the net income in the 4Q. And also they were the main drivers with 8% growth in net income on a yearly basis, reaching 43.1% return on equity, which was 1.3 percentage points higher than the one that we had reported in 2016.

On the premium bonds, page 13, collections get improving on a quarter-on-quarter basis, growing 23% QoQ, and falling 1% year-on-year. On a yearly basis, collections were down 13%. On the flip side, financial results continue to fall and dragged by the lower Selic rate, so the net interest margin was compressed by 270 bps year-on-year, and 110 bps in 2017. So given this weaker financial results and the declining collections, the net income was down 65% year-on-year and up 42% in 2017 in the business is still accretive with a return on equity of 62% in 2017, 39% in the 4Q using a net asset return, despite the low interest rate environment.

At the broker on page 14, brokerage income adjusted for even other events rose 3.7% year-on-year, helped by the increase in commission charged on some life insurance products as well as on the new premium bond portfolio along with a very strong performance in sales of credit life and rural insurance.

In 2017, brokerage revenues grew 0.4% and helped by life which was driven by increase in commission, credit life and rural because of increasing volumes of insurance premiums which more than offset the decline in the other different lines, in pension and premium bonds. But such improvement along with a better EBITDA margin was not enough to offset the weaker financial results, so net income was down 2% year-on-year and 1% in 2017, and same effect here explains the reduction in net margins.

On page 15, we have the accountability regarding the 2017 guidance. So net income change was within the estimates. Our interval was minus 5 to minus 1. We delivered minus 4.8% in 2017 on a recurring basis.

And finally, on page 16, we have our guidance for 2018. So our expectation is that the change in the recurring net income will be between the minus 2 to plus 2 range. Although 2018 is already showing some economic recoveries, still a difficult year from a point of view of the financial results. So, 2017 ended with an average Selic rate of 10%, and the estimates of the FOCUS report of the Brazilian Central Bank points to an average Selic rate of 6.75% for 2018. So interest rates might decline by 33% in relative terms which is even more than the reduction that we saw in 2017.

So financial results will continue to be a strong headwind that we will need to deal with again in 2018. Anyway our intention is to deliver an increasing operating results that can offset full-year impact be declining in financial results.

So that's all I'd like to emphasize, and we may now move to the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Thiago Batista with BBA, with Itau BBA.

Q - Thiago Batista {BIO 15398695 <GO>}

Yeah. Hi guys, thanks for the opportunity. Rafael and Werner, I have a follow-up from the Portuguese conference call. When I ask about the implied financial results in the guidance, you mentioned the client is pretty much in line with the Selic rate, that means something close to 30% in 2018. To have the earnings of around -- of flattish earnings were mainly saying that the operating results will expand low double-digit, a migration [ph] of 13% the operating results. This number is feasible, this level of growth from the operating, I know that you don't have a guidance, et cetera, but this level of expansion of the operating result is feasible in 2018?

A - Rafael Sperendio {BIO 18963159 <GO>}

Hi, Thiago, Rafael speaking. So your estimate is pretty much in line with ours. So, it's totally feasible.

Q - Thiago Batista {BIO 15398695 <GO>}

And do you have any idea which lines will lead the expansion?

A - Rafael Sperendio {BIO 18963159 <GO>}

Mainly an improvement in the commercial performance of some business lines. It's worth mentioning that with a very strong increase that we saw in credit life in the second half, we'll start to accrue results in 2018 besides the sales that will be made also throughout the year. But we will start to get the benefit of the strong sales performance in credit life that we had in second half of 2017, and also some improvements on the expense side.

So we had a very strict, I would say, cost control, when we were designing the budget for all the affiliate companies in first half for 2018. So we will be looking at these expenses very carefully throughout the year and we believe that this is going to bring some improvements for the non-interest operating results. So these are the two most important business line -- sorry, segments that we believe that will show some improvement in the operating side of the business.

Q - Thiago Batista {BIO 15398695 <GO>}

Okay, thanks a lot.

Operator

Our next question comes from Lucas Lopes with Credit Suisse.

Q - Lucas Lopes {BIO 18956724 <GO>}

Thanks for taking my question. It is a very simple one. I mean, you have announced the higher payout ratio for the second half of 2017. Can you share a further rationale of the increasing -- the increase in the payout, and whether or not this is sustainable for this year as well or even this should be the new target of management for the medium to long term?

A - Rafael Sperendio {BIO 18963159 <GO>}

Hi Lucas, it's Rafael. So regarding the rationale behind increasing the payout ratio, it's worth mentioning that our intention is to maximize the distribution of dividends to shareholders. So if we don't find that we have good reinvestment opportunity and return that we think that makes sense, we will distribute it to shareholders. So we also analyze and we are in a difficult economic environment of course, with better prospects from 2019 on, that we are still in a transition phase. And we found interesting new option of increasing the payout ratio in order to offset temporary lower pace of growth in net income.

So besides the accounting net income growing 0.9%, as I mentioned in the presentation, we managed to increase dividend by 4.4% and we had the same strategy in 2016, when we increased the payout ratio from 80 to 82. Now we are increasing from 82 to 85, and this is going to be our intention from now on, and maximize as much as we can the distribution of dividends to the shareholders unless we have moving investment opportunity, but it's not the case right now.

Q - Lucas Lopes {BIO 18956724 <GO>}

Okay, Rafael, 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>}

Well, I would like to thank you all once more for listening our earnings call. We do emphasize that the management is very committed to generating very strong operating results despite still tough year in terms of financial results. We believe that we will be able to view a very strong operating revenue stream in 2018 as we did in the second half of 2017. And to get benefit of this improving commercial performance, continuous improvement in the operating performance. And I get all these benefit in 2019 when we won't have these headwind coming from the financial results anymore and get closer to the potential growth rate that we believe that the company is able to achieve. And in the meantime we will keep working on alternatives to maximize the return on equity and to increase the entrants [ph] to improve the capital allocation among the main business lines that we have. 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 material used in this conference call is available on BB Seguridade's Investor Relations website. Thank you very much for your participation, have a nice day. You may now disconnect.