

Y 2019 Earnings Call

Company Participants

- Bernardo de Azevedo Silva Rothe, Chief Executive Officer
- Rafael Sperendio, Head of Finance and Investor Relations

Other Participants

- Mariana Taddeo, Analyst
- Otavio Tanganelli, Analyst

Presentation

Operator

Good morning, everyone, and thank you for waiting. Welcome to BB Seguridade's Fourth Quarter 2019 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 RI website at www.bbseguridaderi.com.br/en.

Before proceeding, let me mention that forward-looking statements that may be made during this conference call regarding expectations, growth estimates, projections and future strategies of BB Seguridade are based on management's current expectation, 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. Bernardo Rothe, BB Seguridade's CEO; Mr. Werner Sffert, BB Seguridade's CFO; and Mr. Rafael Sperendio, Head of Finance and IR.

Please, Mr. Rothe, you may now begin.

Bernardo de Azevedo Silva Rothe {BIO 18059993 <GO>}

Good morning, everyone. Thank you for participating on our conference call. We had a very good year in 2019. And as I mentioned in our conference call last year, or my first conference call, our goals are still the same and our focus on improving clients' experiencing -- experience, improving sales force experience and improve NPS overall. That's translating five objects to our companies that's now a strategy, that's a means. And by the way, you have that in our presentation that we gave to analysts in November, so

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you have the information on our website. And these objectives are being capitalized and efficient, meaning lean structures and simple profits reflect high value generation. We want to turn customers into fans, product services journeys and relationships that delight our customers. So combined online and offline store will sell more, meaning being prepared for the new world, at the same time that we have new channels, offers and distribution models. Connect and accelerate the digital means to optimization in digital transformation as are competitive attributes of our business and also innovate, so we try without fear to hit the bull's eye. Turning the future, the new and the unknown into the lives of our strategy.

Overall, the results are -- we want to have outstanding value proposition experience to our clients to focus totally in our customers. We are in constant search for improvements in the sales force journey, meaning know the people that's in the front in the Banco do Brasil network, have to have a very good experience selling our products to sell even more. We have to be strong in both traditional digital channel and our IT platform has to enable delivering solutions quickly, both innovation and also as a reaction, as I mentioned, in the previous calls to everyone, at least we have to be a fast forward.

In 2019, we had good operational performance in our company, especially in the insurance brokerage. Last year, we've relaunched our incentive programs to Banco do Brasil's sales force in April, with good results. In fact, with this incentive program, the sales force of the bank staff willing to sell the products more than before. This incentive program that we call (Foreign Language), true translation of that is Seguridade mobilization in full. These programs encompass all the sales force of Banco do Brasil. We -- the idea was to have a gamification of the process of selling and recognition of the efforts of the sales force. And we use for some of the sales force that are basically selling at these new type of branches that Banco do Brasil launched, but they are serving whoever comes in. We have the -- a scratch lottery that they have instant prize anytime they sold a product of BB Seguridade.

We increased the use of digital media and the data analytics throughout the process, also to improve our ability to sell directly to customers, to improve our digital presence with more products available and better customer experience. Not only that, but also looking at sales force, we trained them with more than 40,000 classes throughout the year. So they can improve the quality of the sales.

Our NPS improved in 2019, but they still have a lot of work to do to improve the client satisfaction, so we still have to work on NPS throughout 2020, 2021 and so forth. But as a result of that, clients' complaints have reduced and we still have to keep working on that to have a better experience to the clients. Retention improved and will continue to be our focus. It is better to keep our clients than getting new clients.

We also invest now through other companies with a lot of training throughout the year. Important to mention as well that in 2019, we had a reduction in capital of BRL2.7 billion and we are operating now with 7% less capital than what we had at the time of the IPO, with 2.5 times the net profit of that time. And we are going to pay BRL5.6 billion dividend in total. That, together with the capital reduction, the dividend yield rose to 14.9%. That's a very high number, right?

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For 2020, to deliver on our guidance, we intend to improve life insurance portfolio with new products. We have to improve our home insurance product as well. We have new developments in terms of solution for companies with focus on SMEs. In agri business, we are working with new channels for distribution. We are starting to issue more non-finance areas, non-finance by Banco do Brazil areas. So increasing the total area that we can have insurance. And we'll start soon to issue (inaudible) type of finance as well. That means we are prepared to replace Proagro in the near future. The Proagro is the insurance program of the government.

We -- as I mentioned, the (inaudible), the incentive program now we'll launch a new one. We reset all the programs and now we are calling it (inaudible) meaning in English (inaudible) plus. That use a different type of instant prize based on our roulette instead of scratch lottery. With a face lift in the website and app coming soon and all of that to keep the sales force engaged with our products. Gamification that are priced for the best performance. So this type of engagement is very important to keep growing the sales in Banco do Brasil network. We are still improving NPS and reducing complaints, meaning that's still our focus and keep working with client retentions with several initiatives in place that we believe is going to help us deliver on that as well.

With all that just for starting, right, I'm going to pass to Rafael, who's going to make the presentation for you. Thank you.

Rafael Sperendio {BIO 18963159 <GO>}

Thanks, Bernardo. Good morning, everyone.

Let's start the presentation on page number two. We have here a brief snapshot of our performance in both fourth quarter and full year of 2019. So in the quarter, net income rose 35% to BRL1.1 billion (inaudible) of course somehow from the financial results and also a very robust commercial performance and an easy comp in the fourth quarter 2018, as there were several adjustments on provision in the insurance operations right after the JV restructuring with MAPFRE, as we've given out these effects in 2019. So the increase in income on a year-on-year basis was also helped by these easy comps.

Talking about the performance of (inaudible) very briefly I'm going to cover it in more details going in the presentation. And insurance premiums were up 4.6% year-on-year to BRL2.3 billion and the combined ratio improved by 17.6 percentage points. So a very material improvement to the combined ratio on the back of very good performance in terms of loss ratios, mainly in life and credit life. And also, lower G&A is due to these lower provisions in the fourth quarter last year.

About pension plans, inflows grew 3.1% year-on-year to almost BRL11 billion and the retention ratio fell by 0.8 percentage points, and at the lowest level ever. About distribution, brokerage income grew 2.9% to BRL984 million, while the net interest margin fell by 1.8 percentage points and mostly they are getting through a -- I would say, a more expensive mix of products being sold in the fourth quarter last year as compared to the same period of 2018.

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Talking about the yearly figures in 2019, the net income -- recurring net income amounted to BRL4.3 billion, up 21% compared to the 2018 figure. It was the all-time high recurring net income. The accounting net income was also the highest ever, it amounted to BRL6.7 billion and the payout ratio on this BRL6.7 billion, it's important to recognize that our payout ratio is based on the accounting net income, it was up 83.6% with -- together with the capital reduction that is in place now of the BRL2.7 billion. We have an yield of 14.9% to our shareholders if we were to compare the 12 months of inflow starting the ex date of the 2018 proceeds as of mid of February of 2018.

The performance of the year is of course highly supported by solid operating trends and also by strong financial results, mainly at Brasilprev. And I'm going to cover this on the next page. But regarding the operating performance, premiums at Brasilseg grew 13% compared to 2018. Combined ratio fell by 2.1 percentage points, also explained by lower loss ratios and lower G&A. Pension contributions grew 21.5% to BRL42 billion and the retention ratios by 0.8 percentage points. P/VGBL reserves amounted to BRL279 billion, up 13% in one year, while the brokerage income grew 19.1% to BRL3.5 billion, with a flat net margin.

So we -- when we look at the macro environment that we delivered this net income on page number three, we see that on the negative side of financial results, on the upper left hand side, we take the -- a lower average SELIC rate, so this was the most straightforward effect that impacted our financial results. But on the (inaudible) side, we saw lower interest rate environment was overshadowed by the mark-to-market means arising from the flattening yield curve, as you may see. On the upper right hand side, the dark blue line represents the beginning of the year and the dark yellow line represents the end of 2019. So this helped a lot with some mark-to-market incoming with as Brasil cut about half of all the companies overall, but the most important impact came from the premium bond companies. And also, the main driver here for financial results CapEx, they're going to land in the end of the year, was the favorable dynamics of the inflation rates that accrues in assets and liability of the defined benefit pension plan.

So it's right here on the table, on the lower left hand side, let's focus here on the yearly figures. We can see that most of the assets that wasn't like collateral of these liabilities, they are pegged to inflation, both IGP-M and IPCA and the current inflation rate is used as the accrual rate of these investments. On the flip side, accrue the liabilities, most of them, they are pegged to the IGP-M. In the case of the liabilities, the accrual rate is lagged by one month on average. So we can see that in 2019, inflation didn't change much compared to 2018, but the lag at IGP-M fell substantially compared to 2018 from 9.7% to 4%. This was mainly due to the spike in the index due to increasing the price of the meat [ph] that affected mostly the December figures. So we have impacted the yield and the assets that didn't have the impact in the liabilities, that's going to come just in January this year. So together, all this flattening yield curve and the inflation dynamics throughout the year, they drove the financial results up by 28% accounting to nearly 20% of demand income. And this was the main source of this alleviation from the estimated net income growth.

As we can see now on page number four, our guidance range for 2019 net income growth was from 13% to 17%, and we delivered 21%. For insurance premiums, the end of

the year within the guided range was from 10% to 15%, we delivered 13.9%. It's worth highlighting here that does not consider the name of our insurance from the government to DPVAT and we are comparing apples-to-apples here, right, it's not compared to the reported figures of 2018 as compared to the pro forma periods of 2018 that I consider the same structure we have nowadays replicated to 2018 figures. And for the growth in the reserves, P/VGBL reserves, we also outperformed the guided range that was from 9% to 12%, we delivered 13.2%, mostly on the back of a very strong returns of the investment fund, where these products, they impacted many of the clients.

Now moving to page number five, let's start -- briefly talk about the performance of each business line. Comparing, again, apples-to-apples. Yes, we can see that premiums grew 4.6% year-on-year in the fourth quarter. And this was mostly given the very strong performance on rural that grew 15%, while credit life fell by 12%, and this was mostly related to the fact that we increased the focus of the distribution in the end of the year on term life that grew 11%. When we look at the yearly figures, premiums were up by 13%. And the main driver was credit life that grew 44%, rural grew 12% and term life was up 7%.

Looking at some few operating metrics now on page number six, so you can see the adjusted combined ratios on the lower right hand side presented a material improvement of 6.8 percentage points year-on-year in the 4Q, as the G&A ratio improved substantially, given that there were many provisions that were strengthening in the fourth quarter 2018 right after the realization of these actions that we did in the fourth quarter last year. The loss ratio also stood out. The very good performance in term and credit life in the fourth quarter, that repeated again in the -- for the full year, more than offsetting the increase in the loss ratio we had in the beginning of the year due to some adverse client review impacts. While the commission ratio improved by 6.8 percentage points and on a year-on-year basis, this was mostly related to the increase of the performance from our sale to (inaudible) outperforming the sales targets in credit life and credit life for farmers. So this was a very solid operating trend for the full year, these effects, they were almost the same that we had in the fourth quarter on a year-on-year basis. Very good improvement in the operating performance overall that helps the company to offset the decline in the financial results.

As we can see on page number seven, financial results fell by 57% year-on-year in the fourth quarter, given that the fourth quarter 2018 was topped by some reversals of provisions of accrual from the maintenance, judicial deposits and provisions for claims to be settled. So these affected positively financial status in 2018, but these had been happened in the fourth quarter 2019. And again, the most straightforward effect was for a drag for financial results that was the lower SELIC rate, as the insurance company Brasilseg has a high concentration of investments in floating rates. So this has a direct impact that also explains the 21% decline in financial results when we look into yearly figures. And the resultant, I would say, of all these moving parts, the net income increased by 19% as compared to 2018, while the fourth quarter number increased by 96%. It was mostly driven to the fact that in 2018 our performance bundles from April to December, this bonus was fully boosted in December of 2018. So this has some impact. These numbers are not really comparable.

Moving to pension now on page number eight, contributions amounted to BRL42 billion, up 21% in 2019. While redemption ratio fell almost 100 basis points to 6.9% for the full year driving net inflows up by 54% to BRL12 billion. Pension reserves overall, they have reached BRL290 billion, up 13% in 2019, while the management fee grew 8% in 2019 with the average management fee charged keeping the same pace of decline of nearly 1 bp per quarter. But net income grew 41% in 2019, helped not only by the improvement (inaudible) mainly by the increase in financial results, as I explained previously.

Moving now to premium bonds on page number nine, collections grew 17% in 2019 with an increase in the average ticket of single payment bonds with a longer duration. Financial results were up 5%, given wider net interest margin, as you can see in the yellow line, the lower left hand side, the net interest margin improved by nearly 30 bps, given the lower cost of liabilities, this has allowed financial results in 2019 helping somewhat to compensate the decrease in operating results. So this led to a decline in net income by 10%, given the increased participation of the new portfolio and monthly payment bonds at a higher commission through the broker. So this affected some nuanced operating results of the company. That's why this increase in financial results were not enough to offset the decline in operating results and we ended the year with net income down by 10% for the premium bond.

On page number 10, this includes a review of what happened on the distribution side. So the performance was fairly within commercial terms as I said at the beginning of the presentation. So all the most important business lines, they grew double-digits in 2019 with a top line underperformance that is coming from the performance standards, coming to the sales targets in credit life and credit life for framers. So the performance bonus has amounted to BRL446 million in 2019, while in 2018 performance bonus amounted to BRL276 million. It's important also to remember that in the beginning of 2018, we had an extra commission for term life that amounted to BRL81 million. So it was not a performance bonus, but performance bonus was from April to December. But in the first quarter, we have this extra commission for life. So the -- actually this BRL446 million compares to a level of BRL357 million in extra commissions paid in 2018.

Actually, I would like to highlight here that we changed the parameters through the performance bonus, through the period now that starts in 2020 and it's going to expire in 2022 when we will need to discuss again with MAPFRE whether to keep the same parameters or if we want to change it from 2020 to 2022. We are replacing credit life performance by term life and we're going to have an increase of 10 percentage points in rural region. So this was -- our intention is to change the focus more in products side that we have high potential going forward that can help not only the distribution, but also the insurance company to grow bottom line. But it's important to highlight that for credit life, there were no changes. The EBIT margin remained, I'd say, virtually flat in 2019 and net income grew almost at the same pace as the top line, with 19% compared to 2018.

On page 11, please refer to slide six before diving to our estimates for 2020 to put everyone on the same page here. It's worth remembering that we took some actions in 2019 that have worked terrific for shareholders as they provide more focus around the core business of the company and then allocate our capital more effectively, I'd say, more efficiently, but creates a hard comp for us. So if considering that we don't have IRB in our

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portfolio anymore as we divested completely from our stake in IRB July last year and we also expect lower interest rates, almost no mark-to-market gains and we also don't believe that we are going to have the same wholesale scenario we had through inflation as we had in 2019. We are starting 2020 with a like BRL432 million less in terms of our net income. So besides economically, these -- all these decisions, they make sense for us. Returning capital to shareholders, allocating capital more efficiently, it is a hard comparable for us when we look at borderline variation in 2020 compared to 2019.

So in page 12, we present how we are planning to overcome this challenge. So the guidance for non-interest operating results, we expect a 7% to 13% growth rate. On next page, we provide just a -- like how to -- this is nothing more than combining the consolidated earnings -- operating result of all the companies ex the holding, weighted by the economic stake we have in each company. So we expect these operating results that will show how sustainable the growth rate that we produce to grow from 7% to 13% in 2020. For our insurance premiums, we expect them to grow 5% to 10%, and through our pension reserves, we expect to grow from 10% to 13%.

So with that, 'll wrap up the presentation here and we can 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 Otavio with Credit Suisse.

Q - Otavio Tanganelli {BIO 20615779 <GO>}

Hi, everyone. Thanks for the opportunity and for taking my question. I have -- I just wanted to understand a little better the underlying assumptions that you have for the guidance. You said that the reserves on the pension should grow between 10% and 13%. What is the implied growth in contributions that you're seeing? And on the insurance segment, I understand that the credit life product has a tough comparison base. But do you see any deceleration expected for any other product? How is -- on a segment-by-segment basis, whatever is that -- what are you seeing on the margin? Thank you.

A - Rafael Sperendio {BIO 18963159 <GO>}

Hi, Otavio, it's Rafael. Thank you for your questions. So regarding the assumptions that we have for the growth in reserves of pension plans, well, we don't have any guidance for contributions. But actually, we are working on several scenarios. All of them, we are assuming a growth in contributions and we use as a sensitive analysis for the growth (inaudible) mostly the accrual rate and the reverse and redemption rate. So, of course, we expect a very robust performance in contributions, but unfortunately, we don't have any guidance for top line growth at Brasilprev. Regarding the credit life's performance, what -- we have been conservative as of now as we have a completely new scenario not only for credit life, but for loans in general. So last week, the Central Bank reduced its interest rate by 25 bps. And, of course, it can somewhat impact the spreads that banks charge mainly on payable loans. And this can somewhat affect the performance as credit life can

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become some more expensive. So we need to wait. We have two products in the pipeline to address these issues that will reduce prices, of course, changing somewhat the coverages that we provide to customers in order to restate compacted even in this low interest rate environment. So expecting a more aggressive growth in term life (inaudible) as Bernardo mentioned, offering insurance products to areas that I've not seen financed by Banco do Brasil. It has an announcement that the government that -- is willing to increase the subsidies from nearly BRL400 million in 2018 to almost BRL1 billion in 2019 -- sorry in 2020. We are more conservative in credit life as we have a completely different scenario that we had in our history.

Q - Otavio Tanganelli {BIO 20615779 <GO>}

Very clear, Rafael. Thank you.

Operator

Our next question comes from Mariana Taddeo with the UBS.

Q - Mariana Taddeo {BIO 15009172 <GO>}

Hi. Good morning. Thank you for the opportunity for making questions. I would like to ask about the performance bonus that is accounted as a broker. This year, I understand the bonus was related to life and credit life for farmers and the gain booked at the broker was around BRL447 million. I'd like to understand for this year, 2020, what lines are subject to these performance bonus? And if you could remind us how much is the gain of the broker when the target is reached? I would appreciate. Thank you.

A - Rafael Sperendio {BIO 18963159 <GO>}

Hi Mariana, it's Rafael. Thank you for the question. So regarding the performance bonus, it's worth highlighting that according to the operating agreement we have with MAPFRE, we can reveal the parameters every two years -- sorry, every three years. So it doesn't mean that we need to change, but we have the opportunity to rebuild. So we had a very successful, I would say, period of two years of 2018, 2019 in credit life and credit life for farmers. But -- and because of this very successful approach, it led us to reprice this two we have now that can maybe improve the performance in both companies, not only in the broker, but also in the insurance company. So what we found, for example, is that credit life for farmers has a very limited market. So we can -- I mean that we can focus only on the farmers. So it's a very important tool to use to create incentives for the distribution network, we found there could be more -- a more tactical approach to these two by changing the incentives to lines that can have a bigger potential. And this was why we decided to move incentives from credit life to the term life. As I mentioned briefly in the last answer that we have some products in the pipeline, the credit life, but we also have a new product being designed for term life. By maybe the end of the semester, we will have this ready to be sold to customers. And we can take advantage of these moments to create an extra incentive for the distribution network by having the performance bonus also being applied to the term life product. So it's more like we have a target that we have agreed with MAPFRE that for every 100 basis points, we overcome these targets to get an additional 3 percentage points in commission with a cap at 50%. It is the current. Regarding the rural region, it's difficult for these periods, three years from 2020 to 2022,

the increase in commissions are going to be around 10 percentage points and it's not going to be linked to performance. So I'd say, fixed increase from 20% to 30%. So this is what happened to this renegotiation of the performance bonus.

Just an additional sort of my answer, Mariana, it's also important to highlight that nothing has been changed in credit life. Right?

Operator

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

A - Rafael Sperendio {BIO 18963159 <GO>}

Thank you, everyone, for joining our conference call. Myself and my Investor Relations team, we are available if you have any further doubts. So thank you 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 and have a nice day. You may now disconnect.

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