Q1 2016 Earnings Call

Company Participants

- Rafael Sperendio, Head of Investor Relations

Other Participants

- Eduardo Rosman, Analyst
- Guilherme Costa, Analyst

Presentation

Operator

Good morning, everyone and thank you for waiting. Welcome to BB Seguridade's First 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 Financial Information 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 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 statements of the Company, please check 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, and thank you all for joining our conference call for the first quarter results. So beginning in page three, we have some of our highlights of this quarter, and the first one is our net income, that reached BRL958 million, equivalent to a growth of 1% year-over-year and was mainly driven by the combined net investment income of BB Seguridade and all our affiliates and controlled companies, mostly because of the downward shift in the forward yield curve and the higher average Selic rate.

In our operation with life, mortgage life and rural insurance, we had some improvement in both operating result and net investment income. So it was really close to each other. The underwriting result grew by 15 million while the net investment income rose 12 million year-over-year. In P&C, we can also highlight improvement in the financial results, which grew by 21%. For Pension Plans, we reached 157 billion in assets under management, 31% up in the last 12 months with Brasilprev keeping the leadership in ranking of P/VGBL reserves.

In terms of net inflows, the Company keeps recording very good performance with 56% market share in net inflows for the quarter. In premium bonds, net income grew by 29% year-over-year and was mainly driven by wider spreads and also an increased average balance of interests earning assets. And finally, in the Brokerage Segment, brokerage revenues rose by 4% year-over-year and was mainly driven by a very good performance that we had in life, mortgage life, rural and also in pension plans. We're going to quote a little bit later how these segments reported the growth in brokerage revenues.

Moving to page four, we have a brief overview of the BB Seguridade's performance. So, as you can see, the growth of the net income was boosted by good performance of the financial results, which grew 11% while the non-interest operating results dropped by nearly 4%, and here I'd like to emphasize that this quarter, we had some effects that happened throughout the 12-month period analyzed which turned both quarters not directly comparable.

We explained it in our MD&A but just to summarize here, beginning in June of last year we had three sequential changes in tax rules that affected our company somewhat, was mainly related to tax expenses and in July last year, the increase in social contribution that impacted the income taxes and also in March this year we had a change in the tax regime, the broker that increased its tax expenses on gross revenues.

So because of all these effects, we are comparing a quarter that is the first quarter of 2015 that is completely cleaned of all these changes while the first quarter this year is considering all these changes in the tax rules. That's why in our view, both quarters are not directly comparable and we were already estimating that these would be the hardest comp for the year, the first quarter.

Just to give you some color on it, by combining the earnings before taxes of all our companies, we can see that earnings before taxes were roughly 5.5%, while compared to a 1% growth in net income because of the -- mainly the change in the social contribution. So it was the main effect and that's why we believe categorically the first quarter is the hardest comp that we're going to face throughout 2016.

On page five, we can really show why such a good performance in financial results in almost in all companies. We can see that the combined net investment income of all our affiliates and controlled companies, net of taxes, was 11% higher year-over-year. It's mainly a result of higher yields on financial investments. And you can see on both the left and right-hand side, that the higher average Selic rate and a downward shift in the forward yield curve supported the growth in the financial results mostly in the companies that have a higher exposure to fixed and floating securities, mainly SH2, the P&C company and also Brasilcap, the premium bonds company. These two, they were the ones that benefited the most because of the environment from financial results.

On the other hand, you can see on the lower left hand side, the dynamics of the inflation rates. The lower inflation that we had this year hurts the return on inflation for affected securities held to maturity, specifically in SH1 and also in Brasilprev, we had a very peculiar dynamic that's related to the difference between these two inflation indexes, IGP-M and IPCA. So we have a higher concentration of IPCA inflation-protected securities held to maturities in Brasilprev, the pension plan company, while the liability of this company has a higher concentration in IGP-M.

So, the financial results of Brasilprev was benefited in the first quarter last year because of these spreads that we had in terms of IPCA as compared to the IGP-M. When we look at the dynamics in this year, it was completely the opposite. We have a higher IGP-M as compared to IPCA and that's why the financial results for Brasilprev dropped year-over-year mostly related to these dynamics.

And moving to page six. We are going to start to cover business by business in more detail. So beginning with SH1, the life and rural business, we can see that premiums written were down 2.9% year-over-year and mostly as a result of the weaker performance in credit life. And this spotlight here is on the performance of the life insurance premiums, which grew by close to 11%, mortgage life that grew nearly 12% and rural which grew 61%.

But on the other hand, when we look at the business and the sales mix here, at higher concentration and better pace of growth in the rural segment, that's aligned that we do not retain that much risk. Mainly in the crop insurance, we have retained just 20% of the risk. We've seen that premiums dropped by nearly 7% because of the higher concentration in rural in total premiums written.

On page seven, we can see the operating performance of this business segment. So, as you can see, the combined ratio deteriorated by nearly 350 bps, and explained mainly by higher claims in credit life segment, as well as an increase in the G&A ratio, mainly because of higher contributions for the funds, for the stability of the rural insurance in Brazil. So, this is a total linkage to the higher participation of the rural in premiums written.

And also, in the case of G&A, higher expenses with allocation and operation because, as that we already mentioned in the last call, both SH1 and SH2, they are moving to a new headquarters. So we also have some concentration of higher expenses mainly related to rentals, I think with third quarter last year and we do believe that from second quarter on, as that movement is almost done, we do believe that this G&A ratio will normalize going forward.

On the claims side, we can see that the loss ratio was impacted by the accounting of additional claims in the product that we call non-contributory product in credit life, that -- just to explain it in more details, we have two big segments in the credit life. So one that's offered to clients, so clients are paying premiums to insure their credit operations and the other segment that we also offer a credit life insurance is the one bought by Banco do Brasil. So the bank also insures part of its portfolio against the death of the client.

So in this segment specifically, because of some mismatches that we had in our database we have some claims that were not reported and we identified it in the first quarter, because of these mismatches we now are making a normal process.

So if we don't leave that business, on -- be at the recurring level in terms of how claims in the credit life segment probably from the second quarter on, it's going to normalize, because of all these claims that were not previously reported, they were totally concentrated in the first quarter this year. So this almost explains totally the increase in the loss ratio from 32.8% to 34.3%. If we were to exclude the impact in credit life, the loss ratio would have been 32.7%, a little bit lower than the one reported in the first quarter of last year.

On page eight, we have the breakdown of the SH1's net income, which dropped by 3% year-over-year, and we can see from the upper side here that the underwriting result was up 7% while the net investment income rose by 7%. So that the main reason for this fall of 3% in net income was totally related to the increase in the social contribution according to regulation in force since September last year. So, this was the main reason for the drop in net income, while we can see that both operating and our net investment income grew at the mid-single digits as compared to first quarter.

Moving to P&C on page nine, you can see that the top line, premiums written, grew by 3% driven mainly by the casualty insurance, which increased by 18%, while the auto insurance was down 10%. And in terms of retained premiums, we can see that it dropped by nearly 4%. This is totally related to the increased share of casualties in total premiums written. So it's like the rural in the case of (inaudible) that also demands a higher level by reinsurance, that's why besides total premiums written at 2.5%, retained premiums dropping by nearly 4%.

On page 10, we have the operating performance of these business segments. So the loss ratio was up 470 bps mainly due to higher claims in auto insurance because of the increased robberies and theft, and increasing the usage of sequences and this was the main driver of this loss ratio when we look at a year-over-year basis. The commission ratio rose by nearly 110 bps. It's totally related to the sales mix, more concentrated in casualty that has a higher commission ratio.

And in G&A, it rose by 70 bps and was mostly driven by strengthening provisions for IBNR, incurred but not reported claims and IBMER, that's incurred but not enough reported claims. So we increased provisions for these types of claims and was impacting the G&A ratio for SH2. Besides also the fact that it's also moving to the new headquarters.

So, as a result of the increased loss ratio, commission ratio and G&A, the combined ratio went up by 620 bps year-over-year. And as a result and on page 11, we can see the breakdown of the net income. The underwriting result was negative 105 million. As I explained before, it's totally related to the performance and combined ratio, but on the other hand we had a very good net investment income performance.

So financial results were up 21% and as also I explained previously, it's a company that has a higher cost of inflation in securities, floating rates and fixed rates as you can see on the -- from your right-hand side. It is also helping to boost the performance in the net investment income. That's why SH2 financial results grew by 20%, while the financial results in SH1 grew at mid-single digits.

On page 12, we have the pension plan business. As you can see in this quarter we had a drop in both contribution and net inflows, which is totally explained by the strategy adopted this quarter to focus more on periodic contribution plans, mostly monthly contribution plans, which present a lower average ticket as compared to the sporadic contribution plans, but clearly are really helpful in terms of building a more stable revenue stream going forward.

So, besides not contributing that much in the first moment, it helps a lot to build a more stable revenue stream in the future and also it's very sustainable for the company. When we look at the redemption ratio, it was at 9.2%. So annualized 9.2% of the assets, annualized were between in the first quarter this year, equivalent to a drop quarter-on-quarter of nearly 30 bps and a slight increase year-over-year, the total in line with the most recent historical behavior.

We can see on the upper right hand side that total assets under management grew by 31%, reaching BRL157 billion and management fee grew by 25%, a little bit below the growth of AUM, but which is -- was mainly due to the 7 bps lower average management fee, total in line with the increased share of high net-worthy individuals in the client-base and also a reduction in the share of the traditional plan, the defined benefit plan and then the AUM which was the main driver of the decrease in the average management fee charged.

So, we can see that the outcome was a net income of 223 million for the quarter, 1% up year-over-year, but when we look in the earnings before tax figure we have a growth of nearly 10%. So -- also, Brasilprev was also impacted by the increase in social contribution. This was mostly -- and the performance in earnings before taxes were mostly related to increased management fee in terms of increased AUM. And also, we have a good performance in the cost to income ratio because of the strict control of expenses that we have in the company. So a very healthy performance for the pension plan business.

On page 13, we have our performance in the premium bond segment. So collections achieved BRL1 billion, 21% down year-over-year and mostly related to the -- this drop was mostly related to the lower average collection. So, the total bonds outstanding grew by 9% while collections dropped by 21% and it can be explained by the higher share of monthly payment products and total collections, and also a decreased average collection per bond.

It's worth noting here that besides the drop in top line, the net income grew by 29% and was totally supported by the growth of 71% in the financial results.

As you can see, because of the wider spread that we were able to achieve, as I've told previously, the downward shift movement in the forward yield curve and the higher average Selic rate helped a lot the financial results of the premium bond segment. So we were able to reach a 130 bps spread in the quarter and also is worth highlighting the increased balance of -- for interest earning assets.

And finally, on page 14, we have the Brokerage Segment. So, revenues were up 4% year-over-year and boosted mainly by SH1. It is also linked to a very good performance that we've managed to deliver in the life segment, which grew by nearly 11%, 61% in rural and 12% growth in mortgage life. So, these were the most important drivers for SH1 and besides the accounting mismatch that we have there, so it's also worth to highlight here besides credit life keeping a weak performance of minus 62% year-over-year, it still has commissioned our best sales accruing into the income statement of BB Corretora that's also helping the growth in brokerage revenues arising from SH1.

And besides that, we can see that the patient lengths also helped the growth in brokerage revenues because of the focus on periodic plans (inaudible) having a drop of 6% in total contributions. We can see that the revenues -- brokerage revenues arising from Brasilprev. They grew year-over-year and mostly related to the focus on periodic plans that also offer a lower volume of contributions to the pension plan company. But in terms of new sales, they pay a higher commission as compared to the sporadic contribution plans. This also helped the growth in revenues at Corretora. And as a result, we can see that net income reached BRL371 million, 5% up year-over-year and also the net margin growing by nearly 60 bps year-over-year.

To wrap up here the presentation, we have on page 15, the guidance for 2016. So this quarter, our net income grew by nearly 1% below the range that was delivered in the first quarter, in February this year when we released the 4Q results.

So we were estimating a growth from 8% to 12%, and the main reasons for missing the guidance were, first of all, the basis are not directly comparable, as I mentioned previously, because of changes in tax rules that we had in the second half, mainly in the second half of 2015, related mostly to the increase in social contribution, reinstatement of tax expenses on financial revenues earned by the holding companies and also the change of the BB Corretora tax regime to the noncumulative system in March this year also led to a rise in tax expenses on the gross brokerage revenues. So we can see that our both quarters are not directly comparable.

And besides that, another reason for missing the guidance were the -- of course, the weaker than expected performance in credit life insurance, and also a higher level of claims in the -- or the rise in the segment -- issuance segment due to the increased loss ratio in the credit life and auto insurance mainly. It's worth noting here that the guidance is for the full-year. So maybe when we have changes like these ones that we had in tax rules, it has a big impact in partial comparisons. So these effects, we do believe that's going to be diluted throughout the year, mainly in the second half when the change in tax rules begin to reinforce.

Just remember, if we were to equalize the tax rates in both quarters, as -- and also if we were to remove the effect of (inaudible) we can also call, it's almost one now, effect of the increase in the loss ratio in credit life, the growth in net income would have been nearly 7.5% and that's why we feel comfortable that we can keep the range of the guidance and the expectation we can change the guidance for the full year (inaudible).

So, that's all we had finalized all the presentation here and thank you all for listening and we can 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 Guilherme with Itau BBA.

Q - Guilherme Costa {BIO 17950499 <GO>}

Good morning, guys. Thank you for the opportunity and congratulations on the results. I have two questions. The first is on your guidance. We know that the results represented 22.5% of the low-end of your guidance and we know that you suffered the impact of the higher fees, taxes in this quarter.

But my question is how comfortable you are with your earnings guidance, especially considering that the market consensus expect Selic rate to decrease in the second half of the year?

And my second question is about the performance of credit life insurance product. We saw a mature contraction in the written premium growth of credit life insurance. Could you comment if this is expected to increase in the coming quarters and also, could you comment out of the contraction, how much was due to the cancellation of company's credit life, and how much is due to the low credit origination? Thank you.

A - Rafael Sperendio {BIO 18963159 <GO>}

Thanks, Guilherme [ph], Rafael Speaking. Thank you for the question. So when we look at the guidance, we -- as I mentioned we are very comfortable up to now to keep the range that we close it from 8% to 12% growth. And when we look to the contribution to the full year net income, you mentioned also it accounts for nearly 22% considering the bottom of the guidance.

If we want to look at previous years in how the net income was distributed throughout the four quarters, just going towards shareholders productivity that we had in the financial results.

And if we go back to 2014, 2013, we can see that the distribution of the results throughout the year was nearly 22% in the first quarter, 24% in the second one, 26%, 28%. That's on average, how the results can be broken down in the four quarters of the year. So, it's not very different from the level that we saw in previous year despite these volatility that we saw in the most recent periods in the financial results.

So, and as I mentioned, we look at the first quarter of 2015 as the most difficult comparable quarter that we are going to have this year, mostly because of these changes in tax rules. And if we were to exclude these effect, you can see that earnings before taxes grew by nearly 5.5% and also setting apart the increased loss ratio in credit life that we do not believe that's going to be recurring, the growth rate would have been nearly 7.5%.

So, because of these effects, the operating performance is really in line with our expectations. The only one that is not really in line is the most recent performance of sales in credit life and mostly related to a higher cancellation. Normally, we have higher cancellations in the beginning of the year but this year, it was slightly higher than we had in 2015, but it's also a decreasing trend when we look for the full year. It reach -- peak mainly by February and then it goes down and also has some decline in July and December, but well below the level that we have every February. That's why we feel comfortable that credit life will recover the performance throughout 2016.

And besides that, once again, the level of claims that we had in SH1, we don't believe that's going to be recurring. Probably, it's going to slow down in the next quarters, as well as that the G&A ratio probably will decrease slightly because of the end of the process of moving to a new headquarters in SH1. And also we can expect a better performance in financial results in Brasilprev that was impacted by the dynamics of ICPA and IGP-M cancellation rates, that was very (inaudible) in first quarter last year and hurts the financial results of this segment early this year.

So we did leave that out. Going forward, as we're going to face more fair comparable basis in the next quarters and also a more normalized loss ratio in SH1, SH2, and also a better performance in sales for credit life, and also in pension plans. And we are going to start to focus more now in historic wins, we will be able to reach the guidance by the end of the year. That's our expectation now.

Q - Guilherme Costa {BIO 17950499 <GO>}

Okay. Perfect, very clear. Thank you, Rafael.

A - Rafael Sperendio {BIO 18963159 <GO>}

Thank you.

Operator

(Operator Instructions) Our next question comes from Eduardo Rosman from Banco BTG Pactual.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Hi, Rafael. Hi, Werner. My question is on 2017, I know we're still in May and it has been very tough to have a longer-term view on Brazil even when talking about the next 12 months, right, but what can we expect in terms of your results for 2017, right, because the scenario for growing premiums remains a very tough one, to say the least, right.

And it seems that there is a very good chance that Selic rate will start moving down in the next six to 12 months, right. So I wanted to know if it's fair to say that it will be very challenging for Seguridade [ph] to show any earnings growth at all like next year in 2017, right?

And I also wanted to understand, what can you do to avoid this scenario? Is it just a matter of waiting for the market to recover or waiting for a Banco do Brasil to start growing again its loan portfolio or can you change the mix of the products, increase penetration and to increase efficiency? So, if you can elaborate a little bit, it would be interesting for us. Thanks a lot.

A - Rafael Sperendio {BIO 18963159 <GO>}

Great. Thank you Rosman for the question. So when we look at 2017, and also I would like to go a little deeper in detail on what the strategy that we have been adopting in 2016. So facing a more challenging scenario for credit linked product, we already starting to focus in life and pension, so that's why you're seeing a very healthy performance for traditional life growing at double digit rate base (inaudible) that we reached last year.

In pension plans, it's going to build a good performance by the end of the year, the drawdown of 6% is totally related of a strategy, totally in line with the budget for the year. So we are focusing in line, are not really I would say strongly dependent on the macro environment. In the case of pension plans, it's mostly related of the under penetration that will keep happening in Banco do Brasil client base, as well as in the life insurance. That's why we are keep focusing in these two lines that we see that there is room to keep growing premiums.

Talking about 2017, something that is very difficult and that's not very clear what's going to happen in next year, mainly in terms of interest rates. If we were to look at a consensus, the Brazilian Central Bank foreclosed a report, it's articulating a drop in interest rates as you have mentioned. So, in this scenario, probably we will see an impact in the financial results of the Company and a lower contribution to the BB Seguridade net income. But with a scenario like that, we can expect a much better performance in the lines that have been affected the most this year.

The other ones must depend on credit origination, mostly credit life. So it's mainly the SME segment, that is the one that's showing the weakest performance within the credit life segment. So in a scenario like that of decreasing interest rates, we can expect as a result, an improvement in the macro environment and probably it's going to be a much better scenario for these lines like credit life, mortgage life for growth, mostly in the SME segment, that's this segment that's most underpenetrated segment in the credit life product.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Just putting the -- let's say, the question in a different way, just wanted to understand here because the way your business model is structured, I understand that after -- if you are growing fast like in the topline, if you decelerate the topline, you don't have the effect on the earnings right away, right, because of the recognition of the revenues and because of the stocking [ph] nature of the business.

So it takes some time, right, for the earnings to decelerate, but if you start after a while, the same thing happened in the opposite direction. If you start growing again the top line, it takes some time for your earnings to accelerate as well, right. So, this is -- can we assume that this is true? So even if in start of '17 we will a recovery in terms of premiums, the effect would be spread out through 2017 and 2018, right?

A - Rafael Sperendio {BIO 18963159 <GO>}

All right. Eduardo, when we look at (inaudible) I forgot to mention, when I started to answer the question, I tried to make a link with the strategy in 2016 and it makes sense what you mentioned but when we look at the strategy that we adopt, it's also totally focused on the wage, try to offset this lack until we start to recover and rebound the performance in topline.

When we focus in life and pension, pension is a very resilient business and we have the advantage of still having an underpenetrated client base in Banco do Brasil. So, it's very stable. We can see despite all these changes that we are having in the macro environment that we think some ratio keeps very stable in a single digit level. So, we do not see any major indication of a change. So it's a cushion that we can count on any -- I would say volatility in terms of sales or financial results going forward.

And then, it's the same case for life, and that's why we have been focusing on it differently from credit life, life being a very profitable line. The credit life is very volatile. So, it's strongly dependent on the credit origination and also is linked to the general market economy and also have a very high cancellation ratio as compared to life.

So, this focus that we have been implementing on life insurance, we believe that it's going to provide going forward a much more stable revenue stream and much more recurring in terms of both accounting perspective and the cash flow for the Company next year. That's why we believe that differently from 2012 or 2013, now we are building a more resilient business to face any major change that we can have in both interest rates, inflation over the next year. That's why we have been changing our strategy in 2016 to focus in these lines, to offset and try to reduce this gap that we may face once the interest rates go down and till we have a rebound in sales.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Okay. Thanks a lot, Rafael.

A - Rafael Sperendio {BIO 18963159 <GO>}

Thank you.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I would 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 joining the call, thank you for the questions and the message that we meant here is also worth to highlight that these are quarters, they are not directly comparable as of all these changes that we had in tax rules, we are ready, we're counting on the first quarter of 2016 as the hardest comp that we'll face throughout the year.

So, we do believe that with all -- when we look and going forward over the next quarters, once we start to compare apples-to-apples in terms of tax pools and also once the claims ratio -- normalizes and also the G&A ratio in SH1 as well as the financial results in the pension segment, we believe that it's totally reasonable up to now to reach the guidance by the end of the year and we do not see any major situation that will lead us to change the range that we have for the growth in net income for 2016.

So that's all. 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 and have a nice day. You may now disconnect.