

Q3 2015 Earnings Call

Company Participants

- Rafael Sperendio, Head of IR

Other Participants

- Guilherme Costa, Analyst
- Jorge Kuri, Analyst

Presentation

Operator

Good morning, everyone. And thank you for waiting. Welcome to BB Seguridade's Third Quarter, 2015, earnings conference call. This event is being recorded. (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 this conference call regarding expectations, growth estimates, projections, future strategies of BB Seguridade, are based on management's current expectations, projections of the future events and financial change 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 today are Mr. Werner Suffert, BB Seguridade's CFO. And Mr. Rafael Sperendio, Head of Investor Relations.

Mr. Sperendio, you may now begin.

Rafael Sperendio {BIO 18963159 <GO>}

Thank you. Good morning; thank you all for joining our conference call. So beginning on page 3, we have the highlights of the Third Quarter.

The first one here, the adjusted net income, that reached BRL988 million for the quarter, equivalent to a growth of nearly 20% year over year, with a higher contribution of the non-interest operating result, that will be BRL99 million as compared to Third Quarter of 2014.

Combined revenues from our underwriting and (accumulation) business, that grew by 10% year over year, driven primarily by the pension plans, which grows nearly 10%. And

premiums written in SH1, our life and rural Company, which increased by 35%.

In H1 segment here SH1 had a very strong operation performance, an improvement of nearly 5.8percentage points in the combined ratio, mainly due to lower (loans) and lower G&A ratios.

In SH2, that's the P&C company, net income grew by 40% year over year, driven by strong performance of the financial results.

In pension plans, we reached nearly BRL138 billion in assets under management, a growth of 33% over the last 12 month. And a very good performance for Brasilprev that enabled it to remain in the top of the ranking in P and VGBL reserves. Then an outstanding performance in terms of net inflows; we accounted for nearly 53% of the total net inflows in the industry.

And finally, the last point that I would like to highlight here is the brokerage revenues, which grew nearly 10% year over year, driven mainly by the revenues arising from SH1 and Brasilprev.

Looking forward here on page 4, we have the one-off items that affected the earnings. In Third Quarter we have (ED) effect of these increased tax rate for social contribution, increased from 15% to 20%. So in the first moment we have a boosted impact in our insurance companies, SH1 and SH2, due to the recalculation of their social contributions for tax assets from (Federal) increased from 15% to 20%, which we get a (postdated) impact in the net income of (BRL42 million).

So just to explain a little bit, these deferred tax assets arises mainly from the temporary differences provisions for low (assets) and other provisions that we expect to be reversed before the end of the year. The effect is that (this rather) increased the social contribution. And also, the other source of these preferred tax assets are in negative basis or accumulated fiscal losses and goodwill that we got from the corporate reorganization that took place during the process of structuring the partnership with Mapfre.

In the other companies we didn't have this before-tax assets in neither fiscal losses. And so on. So they didn't have any impact regarding this increase in the social contribution from September on.

On page 5, we have a brief overview of our performance. Revenues (with) premiums, contributions and collections amounted to roughly BRL14 billion in the quarter, 10% higher year over year. Year-to-date comparative figures, we have an increase of 16% and reached BRL44 billion year to date September, driven mostly by the good performance seen in Brasilprev.

So as you may see on the upper right-hand side, pension plans business segment increased by nearly 4.8percentage points (sharing) in total revenues, as compared to the same period last year.

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And in terms of the net income and profitability, our adjusted net income for the quarter reaching BRL988 million, 20% up year over year. While in the first nine months of 2015, the adjusted net income amounted to roughly BRL3 billion. Here, a growth of 27%, as compared to the same period of 2014, which is equivalent to a normalized return on average equity of 58.4%.

In the earnings breakdown here, we can see that SHI is increasing its share in the net income, mostly driven by strong performance of the non-interest operating result. And also good performance for financial results. We are going to cover it in deeper details, going forward. And also, when we look at BB Corretora, it remains the main source of net income, with a 37% share.

On the financial results, on the next page, page number 6, we have the contribution of the net investment income to BB Seguridade's adjusted net income. So the combined net investment income, net of taxes, was 33% higher year over year. Year to date, it grew by 45%.

So the better performance, in general, here was mostly driven by the higher yields that we were able to achieve in our financial investments. And also, in higher volume of these interest earning assets. Regarding the yield, it's worth noting a higher average Selic rate, as you can see on the upper left-hand side, as well as the strong performance of the inflation protected securities earlier during year.

On the negative side, we have, on the upper right-hand side, the mark-to-market effect, due to the upward shift of the forward yield curve that took toll in the earnings of the affiliates, with higher exposure in terms of the fixed securities, namely the premium bonds company, Brasilcap. Which explains when we look in terms of the change in the net interest (net) income, the drop on a quarter-on-quarter basis, mainly because of the upward shift in the forward yield curve.

It's also important to emphasize that we do not seek an active management of our investment portfolio. The main idea is always to focus on the assets and liabilities management. That's why Brasilcap suffers the most because it has a higher exposure from fixed securities, because the liability risks are almost totally (pre-fixed). So in a way, the focus is always to emphasizing the AuM, rather than seeking for active returns in the short term.

So starting now on page 7, we are going to cover in deeper detail the performance of each affiliates and BB Corretora. And starting here with life, mortgage life and rural business segment, BB Mafre SHI. We have the premiums retained net of premiums ceded to reinsurance here, the retained premiums improving by 21% year over year. And year to date growing by 6%.

In the Third Quarter, premiums written grew by 35% year over year, boosting the year-to-date growth rate from minus 8%, as of June, to roughly 5% year to date September. So such a good performance was driven mainly by the growth seen in the crop insurance, after the release of the working capital loans for the summer crop, that's 2015, 2016, it

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started in July, as well as the growth in the life insurance sold in the bancassurance channel, which grew by 10% year over year.

Financial results. And we have here a growth of 43% year over year, 49% year to date, boosted by the higher yields from investments. And also the higher volume of financial investments. This performance of the financial results, in addition to the strong performance seen in the underwriting results, led to a growth in the adjusted net income of 26% year over year. And 32% growth year to date.

Just to explain in more detail that such a good performance in the underwriting results, we can see on the next page, on page eight here. Looking over to the year-over-year comparatives, we can see an improvement of 5.9percentage points in the combined ratio, mainly due to a much lower loss ratio that was explained by lower claims in private (plans) and life insurance, as well as a better G&A ratio in the quarter.

And regarding the G&A specifically, it was due to lower expenses (we had planned) for the stability of the rural insurance that we have, due to a lower underwriting margin for the segments that contribute to the (profitability). Well that's main the reason, mainly the crop insurance and the rural (within).

So overall, a very healthy operating performance for the Company. And we reached a 68% year to date combined ratio.

On page 9, moving to the P&C business now. Retained premiums dropped by 4% year over year. We have been seeing a more challenging scenario in this segment, mainly for the auto insurance here. And the spotlight is on the financial results for this Company, which grew by 98% year over year, helped by the improvement here in net income, which grew by 40% year over year, nearly 46% as compared to the first nine months of 2014.

In terms of the operational performance on page 10, the P&C business where we saw the combined ratio worsening by 2.5percentage points year over year, mainly due to increased claims in the casualty segment. The G&A ratio also increased by 1.8percentage points year over year, backed by the (transferring) in provisions for loan losses, mainly for (non-insured) operations.

In pension plans, on page 11, we can see in the quarter contributions increased by 10% year over year. Year to date, total contributions (drawing) from the very strong 26% growth, with 30 bps lower redemption ratio. And thus net inflows, the Company keeps doing very well, presenting a growth of (23%) year to date and accounting for nearly 56% of the industry for the net inflows this year until September.

As a result of the very good performance both in gross contributions and net inflows, we could reach, on the upper right-hand side, BRL138 billion in total AuMs. And growth of 33% over the last 12 months.

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The management fee, that's a main source of net income for this Company, it grew by 27% year to date, a little bit below the growth of the assets under management. And the main reason is because of the drop of nearly 6 bps in the average management fee charges as a result of the higher concentration in plans with lower fee charges.

This is a result of the focus that we have been implementing on the high net worth clients, as we have a lower contribution of the retirement benefit plan that's no longer sold. And we charge at a higher rate. So it's been diluted when we look at total AuMs. This is contributing to a decrease in the average management fee charged.

Net income grew by 24% year to date, boosted by the growth in revenues with management fees and also a higher spread between the Company's proprietary assets and liabilities, which helped the financial results in general.

ROAE is around 44%, both for the quarter and year to date. And decreasing as compared to both periods of 2014 because of the increase of earnings retention that we did in December last year to face the new capital requirements for the market (risk) regulations that's going to be implemented in 2016 and 2017.

So moving to the next page, page 12, we have the performance of the premium bond segment. Collections dropped by 1% year over year. And when we look at the year-to-date comparative, it remained flat but with a different mix, more concentrated in monthly payment bonds than we saw last year.

This is also a strategy that we have been implementing and that we focus on building a more stable revenue stream. And we keep this strategy, going forward, with increased contribution from monthly payment bonds.

The financial results decreased by 8% year over year, as a result of the contraction in the spread with an increased yield on interest bearing liabilities, in addition to the negative mark-to-market effect caused by the upward shift movement in the forward yield curve.

So this was the main reason why the net income dropped by 8% on the year-over-year comparative, while the year to date we still see a strong performance. The financial result was mainly responsible for this 19% increase in the net income as compared to the first nine months of 2014.

Moving to now the brokerage (revenues), BB Corretora on page 13. Here, brokerage revenues grew by 10% year over year and nearly 15% year to date. And in both cases, SH1 and Brasilprev were the main drivers. As you can see on the right-hand side, both of them increased their shares in the revenues breakdown.

And here, it's also worth noting the mismatch that we have in terms of the accrual basis of accounting that will result in unearned commissions for the insurance business, SH1 and SH2. While the expenses that we have to reimburse Banco do Brasil for the cost incurred in these expenses, they are paid on a cash basis.

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So as we had a higher (cash flow) was being accrued to earnings without an expense associated to this revenue, it's helping the net margin to increase in addition to the higher Selic rate and the less expenses in our product mix. So that margin grows by 3percentage points as compared to the first nine months of 2014, with a 2.4percentage point increase year over year. That led net income to grow by 15% year over year. And 21% as compared to the first nine months of 2014.

Finally here, on page 14, we have the guidance monitoring. The first item here, the growth in net income, we reached 26.5% growth year over year, above the forecast. And the main reason was that we were able to have much better financial results than we expected, mostly because of this higher average (risk weight), as well as a good performance of the inflation-protected securities earlier this year.

Regarding the growth in SHI premiums, we reached 4.7%, showing a very strong recovery as compared to the minus 8% rate that we showed year to date June. It's still below the guidance. And the main reason for this in the revised guidance is of a more challenging scenario for life insurance in the broker channel, as well as the deceleration that we saw in premiums from credit life insurance.

And in the pension plans, the growth in reserves at P/VGBL, we delivered nearly 37% growth, above the estimate. And the deviation can be here explained by the easy comps that we had in the first half of 2014, due to the unfavorable scenario for pension plans contributions in earlier that year.

Therefore, our expectation is that two of the four quarters of 2014 and the comparison basis becomes even more stronger now, P and VGBL reserves will convert to our estimates.

So this finishes our presentation. I'd like to thank you all again. And we are now open to the Q&A session.

Questions And Answers

Operator

(Operator Instructions) Guilherme Costa, Itau BBA.

Q - Guilherme Costa {BIO 17950499 <GO>}

Congratulations on your results. I have two questions. My first question is about the allocated costs. We saw another contraction in the administrative expenses of BB Corretora. Could you give us more color on why the allocated costs went down this quarter and if you expect them to continue at this level, going forward?

And my second question is about the net margin of BB Corretora. We saw an increase in the net margin of BB Corretora this quarter; do you believe it is sustainable, this level of the net margin of BB Corretora?

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A - Rafael Sperendio {BIO 18963159 <GO>}

Thank you, Guilherme. Rafael speaking. So regarding the question about the lower admin expenses (at broker), it's mainly due to a mix of sales less expenses than the ones that we were being seen in until June this year. And also, in the same (mix) in 2014.

However, the increased participation of the rural insurance, it has a lower reimbursement cost. And while we saw a decreased participation as realized in the life-related and credit life insurance, in terms of mix of new sales. And this is one of the most expensive, as well as the auto insurance sold in the bancassurance channel.

It's also one of the most expensive lines. So these more expensive lines, they lost share in the mix of new sales in the quarter, while rural insurance, that is much less expensive, it increased the share in terms of net new sales in the quarter. That was one of the main reasons why the admin expenses dropped in both the year-to-date and year-over-year comparison.

When we look in terms of the net margin, we have, besides the (paying) effect, two other effects that also helped this net margin to increase. So one of them is the situation that I've explained during the presentation, that is the accrual of unearned commissions for premiums sold two, three years ago.

That commission is being accrued into earnings; it's still being accrued into earnings now, while we do not have an expense associated to this revenue because the expenses are paid on a cash basis. So this is also helping the increasing in the net margin.

And the other point also that is helping such increase in the net margin is the higher average Selic rate, as the vast majority of the over BRL1 billion cash that we have in the Company, I think that's mostly in repos and it has been benefited by these higher Selic rate.

Q - Guilherme Costa {BIO 17950499 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Jorge Kuri, Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

Can you give us some preliminary thoughts on what 2016 looks like in terms of top-line growth? You've certainly proven to be very resilient to the macro downturn this year. I'm not sure if this was something that you expect, going forward, or this was benefiting from some of the accruals that you had coming in from last year. Can you help us understand whether or not you think 2016 could prove to be as resilient as this year? Thank you.

A - Rafael Sperendio {BIO 18963159 <GO>}

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Hi, Jorge. Rafael speaking. Thank you for the question. So we're planning 2016, the main - we are currently now during the budget planning for the year; we did not finalize it yet. But I have provided you some color in the main projects that we have and underlines that we are concentrating our efforts.

First of all, the rationale is perfect. We still see (good) in terms of positive (side) for the earnings in 2016, in terms of the accrual of unearned commissions at the broker. So this will still help the results for 2016.

Also, we plan to keep emphasizing on the sales effort in life, mainly in the pension plans at Brasilprev. The main focus is the still low penetration that we have in Banco do Brasil client base.

So we believe that these, mainly three, effects will help the Company's performance for 2016. But unfortunately, as we are now in the currently budget planning, we cannot give more details right now.

Q - Jorge Kuri {BIO 3937764 <GO>}

All right. 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>}

Thank you, again, for joining the conference call. Thank you, all, for the questions. Myself and my team, Investor Relations in BB Seguridade, remain available for any further clarification. Thank you.

Operator

With this, we conclude BB Seguridade's conference call for today. As a reminder, 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.

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