# Q3 2018 Earnings Call

## Company Participants

- Rafael Sperendio, Head of Investor Relations

## Other Participants

- Carlos Macedo, Analyst
- Rafael Frade, Analyst

## Presentation

### Operator

Good morning everyone and thank you for waiting. Welcome to BB Seguridade's Third Quarter 2018 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/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 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>}

Thank you. Good morning everyone and welcome to our third quarter 2018 earnings call. I'm going to take you through the presentation so let's start on slide number two, where we have a brief summary of what happened in the quarter. So, starting with our reported net income reached BRL874 million in the third quarter impacted by only one extraordinary event that happened at our P&C business at MAPFRE BB SH2 to the amount of BRL18 million. So such event came from the revaluation of the inventory of salvaged vehicles aiming to readjust the accounting value to the -- what we understand that there is a likely recoverable value of these vehicles. So all the things was really affected and it impacted our net income at the amount of BRL18 million in the quarter. So by setting apart this event as well as teh one that affected the bottom line in the third quarter last year, just to remember third quarter this year was positively impacted by the capital gains that we got from the IPO of IRB, so both quarters comparable we are setting apart both these extraordinary events and looking at a -- on a recurring basis, our net income reached BRL892 million in the third quarter this year now, 12.7% from a year ago.

As you can see here on the lower left hand side, the key driver for this decline in the earnings in the quarter was financial results. Financial results were down 44% year-on-year. And the last to extend the operating result also contributed to the decline in net earnings with a reduction of 1.3% year-on-year on weaker volumes for pension and premium bonds. Among the few of the main highlights that help us to build the net income for the quarter we have the 13.5% growth in premium at SH1 driven by credit life and rural. We also saw a very important improvement in the combined ratio at SH2, which came in below 100% versus the improvement in the loss ratio, the deduction in the G&A ratio, and finally our pension after turned amendment of roughly 10% to reach BRL248 billion, in addition to the improvement in the cost-to-income ratio helped the operating results of this business to grow pretty close to 11%.

Turning to the financial growth on page three. I'm going to cover here in deeper details what happened to the financial results that led to the 44% decline year-on-year in Q3. So, as you may see in the lower left-hand side, sorry right-hand side, contribution the financial results to earnings which has been all time low level 16.8% only, and the key drivers for this weak performance in financial results will be -- I will start with the most straightforward one, because they are decline in the average Selic rate. The average rate in the third quarter this year was 6.4% while in the last year it was 9.2%. So just a significant was the average interest rate variation, I mean 30% decline in the average Selic rate. So, this is the more straightforward impact.

On the right hand side we have here the forward yield curve. They also show some impact on comparables here, last year we had a downward move in the forward yield curve. It was almost a parallel move that helped the third quarter last year to get higher mark-to-market gains and pre-fixed securities, that means zero [ph] key for bonds mainly in our premium bonds company. While -- when we look at the dynamics of the curve -- the yield curve this year, we can see that in the short and the curve flattened a little bit while in the medium to the low end part of the curve, we can see that there was a steepening in the yield curve that also affected the mark-to-market of the zero key bonding in the third quarter this year. So, I mean with these dynamics in the third quarter this year compared to third quarter last year, means lower mark-to-market gains.

And finally, the biggest burden on the financial results this quarter was the spike in the IGP-M inflation rate with a more moulded [ph] increase in the IPCA inflation rate. So because these -- with these dynamics, this led to significant increase on financial expenses that add a new graph and over to the defined benefit pension plans, we will mention here that we still have, and that they are no longer sold, but we still have this liability in our balance sheet.

Then as the proportion of the liabilities factored through IGP-M is higher than the assets linked to the same index, big numbers here, all of our liability is roughly 87% factored through IGP-M and less than 1% through IPCA, while out of our assets, 60% is factored through IGP-M and only -- and 37% is indexed to IPCA. So such increase in IGP-M has been a headwind through financial results as the new graph. So that in our opinion, this is one likely short-term effect, that we expect that both indexes should converge over time and we can even notice that in the chart on the lower left hand side, IGP-M was too low last year. It even showed deflation and it's feasible to believe that IPCA will catch-up, but this catch-up might happen maybe in 2019.

Moving now to the performance of our main business on page four. Starting here with SH1. Premiums written grew roughly 14% year-on-year, on the back of a strong performance of credit life, which was up 24% year-on-year and rural which rose roughly 27%. Regarding to the operating metrics combined ratio improved by 20 bps year-on-year, towards reducing the commission ratio, given the end of the temporary increase in the commission laid at some products within the term life insurance portfolio distributed in the bancassurance channel. So this increase in commissions was in force from the third quarter last year and till the fourth quarter this year. So this is explained, mostly the improvement in the combined ratio.

In addition, loss ratio was up 50 bps year-on-year, given higher frequency and the higher cost per plan in credit life and increase in the loss ratio in the rural, increasing a little over, mostly related to the drought that affected the corn crop this year. G&A ratio was up 410 bps, as it will cope up the related to non-performing premiums and the insurance receivables. Financial results grew 2% year-on-year and all-in net income rose 6% year-on-year, the third quarter this year reaching return on average equity of 52%.

Turning now to P&C, on page five. Premiums written were up 12.5% year-on-year, driven by casualties and auto in the independent broker channel.

Regarding the operating performance combined ratio improved at 780 bps year-on-year, driven by the lower G&A and lower loss ratio, across the Board the improvement in the loss ratios, that the banking in the Auto insurance which keeps improving, since the loss ratio was down 510 bps year-on-year. So as a result of this increase in premiums in addition to the lower combined (inaudible) operating result should reach BRL94 million as opposed to a loss of BRL45 million in the third quarter last year. In addition to the decline in financial results of 21% on the back of lower interest rate. The net income of this company has reached BRL66 million in Q3, up 246% year-on-year, reaching a return on equity of 8.2% in the quarter.

Next page, we have our performance in private pension plans. Contribution reached the highest level within the year BRL8.5 billion, but it's still down year-on-year. Year-on-year decline at -- from 19.7% and is still impacted by the macro uncertainties which we hope that will fade out from (inaudible), with income ratio normalized after the impact of the increase of the volatility that has started with the broker striking, May this year, our pension reserves have reached BRL248 billion, up nearly 10% over the last year outlook, and it is increasing in AUM, helped management fees to grow 8% on a year-on-year basis, with the average management fee declining 0.03 percentage points year-on-year.

And when we analyze something that is not here in this slide, but in terms of the cost restructuring in the company also has been increasing. Cost-to-income ratio improved by 270 bps, with an addition to the improvement in the management fee. Operating results grew 11% as compared to the third quarter of last year. Considering the decline in financial results, that we already discussed during the beginning of the presentation, financial results at Brasilprev were affected by the spike in the IGP-M inflation rate. So, financial results dropped 88% year-on-year which left the net income of this business to decline 17% year-on-year and to reach a return-on-equity of 35.6%.

On premium bonds on page number seven, here, we ended Q3 with a BRL1.1 billion in collections, down 16% year-on-year given the weaker sales volume. Financial results fell 62% year-on-year, driven by the compression in the net interest margin, which was mostly driven by the lower Selic rate and lower mark-to-market gain. So as I explained well in -- when we were discussing the financial results of the company, and for this business, specifically as financial results are the primary source of earnings, the net income declined at same pace down 62% year-on-year with a return on equity still well above the cost of capital, reaching 30% in Q3.

And finally, on page eight, we have our insurance broker. Brokerage income fell 11% year-over-year, driven by health soft sale of pension in premium bonds, and to put actually one year on the same page, it (inaudible) accounting dynamics at the broker, the lines that are growing at attractive pace like credit life, like crop insurance are the ones that are deferred into the P&L, while the lines that has been shrinking are recorded on a cash basis. So although the brokerage income have fallen 11% year-on-year in Q3, the balance of earned commission increased by 11% over the last 12 months and reached BRL1.8 billion as of the end of September.

The net income are that they quite appropriate 17% year-on-year driven by two factors, in addition to the weaker top line. So the first one was the reduction in financial results and directly related to the lower Selic rate and the second factor was related to the compression in the EBIT margin which was driven by the increase in the total items sold as you can see on the lower right hand side. The number of products sold in the third quarter this year therefore that's compared to the third quarter last year. And this is totally related to the strategy that we talked about on our last earnings call to shift a little bit before it goes towards low figure insurance profit win. So this is will remain and should be need of third quarter this year, but the fleet side of this strategy is that it takes a call on EBIT margin in the first moment as the cost of products sold consumed being part of the commission.

But this is a one-time effect. It can be either related to the low figure of the product or related to the deferrals. But if you look at that one-time effect, because it might be diluted overtime as revenues will accrue into the P&L and we then have an associated cost with the revenue. We can even see that the EBIT margins are rarely showing improvements on a quarter-on-quarter basis, increased by 30 bps in the third quarter now as compared to the second one.

I will wrap up here the presentation. Now on page nine we have our guidance monitored -- yesterday through September, we underperformed the revised guidance. Our recurring net income was down 8.8% as opposed to the minus 6% to minus 4% expected valuation in earnings according to our guidance.

So the key drivers for the shortfall versus our estimates were it has an -- an expected move within the big layers in the Basin industry to cut lot of features of euro [ph]. So we expect that it might have a negative impact of 0.5% of the forecasted net income for this year. It's also worth highlighting the higher than expected IGP-M inflation rate, we have been waiting on the financial expenses that was repriced [ph] and higher than expected loss ratio for rural because of the droughts that affected the corn crops and also very higher-than-expected loss ratio in credit life.

And it also affected that are also -- has been impacting but a more related to our commercial performance was the all the uncertainties around the Presidential election that happened in October, which brought some additional difficulties to raise funds through our long-term product like financial plan. So although these cycles have been weighing down the bottom line, we believe that it's still feasible to think about our convergence to the guided range in Q4. So while our current expectations form points to fourth quarter being the strongest within the year in order for this to happen we need to comment mainly on the -- four assumptions.

The first one is related to -- as I was covering in the commercial performance in pension plans, and the validation of the loss ratio of life and in the rural as well, the approval of SH2 we are and we hope that we will not see any negative surprises come from the yield curve including investment [ph] year. So according to these assumptions, we believe that the net income will converge to the slow happenings. So out of the last four months, in three months we have got to the average monthly net income that we need to deliver in Q4 to reach the guidance. So I think it's totally feasible to think about this convergence until December.

So, that's all I would like to emphasis and we can now jump into 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 Raphael with Banco Bradesco.

## Q - Rafael Frade {BIO 16621076 <GO>}

Hi, good morning all. I would like to hear from you a little bit of your view on the -- how is the competition on the asset -- on the pension business? How are you seeing competition from asset managers, and if you believe that the model of open to sale to make partnership with asset managers to sell insurance, would be a strategy viable to you guys or if you would be in some disadvantage to not offer this kind of solution?

## A - Rafael Sperendio {BIO 18963159 <GO>}

Thank you Raphael for your question. This -- the model that will -- that we have, not a lead to the banking channel, the bancoassurance using Banco do Brasil branches and all the other channels available in Banco do Brasil to distribute our pension plan. It will continue to be our main strategy, but we are open and we are having -- and we have initiatives in place. To follow this trend that we have in the market, linked to the open platforms, so we will be able to distribute our products using other channels. We don't have any kind of a problem -- problems doing this. And we are discussing this already in the market. And we have also cyclic, that an initiative that we have to distribute products to people that they are not the main target for banks.

They are target for these open platforms on investment, but they are not -- I'll say through the traditional banks, they are targets. So, we are moving a little bit our strategy. But on the next years, we would still have good part of a new flow coming, the net inflow coming to group coming from the Banco do Brasil channel, but of course we are ready and increasing our initiatives to deal with this change in the market environment with these new competitors in place.

## Q - Rafael Frade {BIO 16621076 <GO>}

And just follow-up on this. So it's very clear that you're looking for other channels. But the question is, if you are also looking for other products as you mentioned about this open platform. The idea is mainly focus on Brasilprev through different channels or also maybe you could be offering other products through those channels?

## A - Rafael Sperendio {BIO 18963159 <GO>}

Yes, just -- to just clarify, we will have these different channels and also different products. So, for some segments that we want to have access to order asset managers and product that we don't have in our asset manager that provide the products for Brasilprev, we are able, and now we already have our clients that they are able to reach this product from other players. So, this is the brand as I mentioned, is the trend for the channels and as -- and also a trend to diversify the product available, not only products from our own asset managers, but also products from other asset managers.

## Q - Rafael Frade {BIO 16621076 <GO>}

Thank you.

## Operator

Our next question comes from Carlos with Goldman Sachs.

## Q - Carlos Macedo {BIO 15158925 <GO>}

Thanks, Rafael. A quick question on -- Rafael, you mentioned during the presentation that one of the reasons why you weren't seeing an inflection in the revenues for (inaudible) was that some of the brokerage fees you are receiving were deferred as because of the nature of the product. When do you expect those, I mean, you obviously know the mix there you know when they're going to start hitting your books and being recognized as revenue? When do you expect that inflection to take place and for the revenues were better reflects the recovery that you seen in sales, particularly in SH1?

## A - Rafael Sperendio {BIO 18963159 <GO>}

Thank you Macedo for the question. From that figure -- starting with SH1, we already have a good trend of premiums -- written premiums coming there. But, because we are growing very fast on credit life, this trend of increasing earned premiums and also having a positive effect on our broker on deferred commissions. As aforementioned in our presentation, these commissions they are increasing 11% on earned commissions, but they are -- they will start to be part of our earnings from next quarters on, because we were -- we started this trend of higher credit life growth last year in the fourth quarter, and we are entering the second year now. So, this will start to have a positive effect from the fourth quarter on.

But, to be more strong through 2019, because we will have two whole years of good performance and this growth that will happen. And we will have also a positive effect coming from other products. So the difference that we have nowadays is coming from the contributions from Brasilprev comparing with the contributions that we had in 2017 and '16, is impacting the comps, of course, but from now on, we will continue to have higher commissions coming from Brasilprev, because of this -- the elections that happened in October and the end of this in strategy that we have until now, people they are now restarting the year, saving investments for a long-term profit like the one that we offer in Brasilprev. So these two factors, the second year of a very positive trend in credit life in SH1. And a better year in Brasilprev, we will guide to through air missions on our broker.

## Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. 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'd like to thank you all for joining our earnings call and actually first year our commitment to the guidance, which I remind is still properly feasible, after all the uncertainty as related to the pleasing environment they fade out with now, we know that Mr. Emmanuel [ph], will be the next President of the country. We believe that investors will be, say less concerned about committing their savings with long-term products and when we look at the churn of the products, they have been showing good performance due to the second dynamics of the forward yield curve and it's worth reminding that December is always a good month for pension because in -- we will seek to get their tax benefits related to BGBL and employments results are showing some signs of improvement. So the government is achieving for the better, that's why we are still confident that it's totally feasible, maintaining the guidance range and we hope that are we are going to deliver a good performance to the end of the year. 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 the BB Seguridade's Investor Relations website. Thank you very much for your participation and have a nice day. You may now disconnect.