Q2 2016 Earnings Call

Company Participants

- Rafael Sperendio, Head of Investor Relations

Other Participants

- Gabriel Pimentel, Analyst

Presentation

Operator

Good morning, everyone, and thank you for waiting. Welcome to BB Seguridade's Second 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 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 and thank you all for joining our conference call for the second quarter earnings. So, beginning here on page 3, we have the main highlights of this quarter and the first one here is our net income, which grew 9.3% year-over-year, driven mostly by the growth in combined non-interest operating results and also to a lesser extent, the growth of 83 million in net investment income.

In our life and rural business, the bottom line grew 9.3% year-over-year and driven mostly by non-interest operating result, and also the net investment income mostly benefited by the higher average Selic rate in the quarter. In pension plans, our assets under management grew 31% year-over-year, with net inflows of nearly 60% of the total net inflows in the Brazilian industry, very healthy performance in the pension plans.

In premium bonds, net income grew 6% year-over-year driven by the still favorable scenario in terms of interest rates and at the broker revenues rose 8% year-over-year boosted [ph] by the good performance as I have mentioned in term life, in rural, in pension. And finally, the last point here, the distribution of BRL1.6 billion as dividend, keeping the 80% payout for the semester, so 1.6 billion distributed to our shareholders as dividends.

On page 4, we have the performance broken down by financial and non-financial results. Here, we can see that net income grew 9.9% year-over-year, boosted by the non-interest operating results especially in pension plans and we could see a very good performance in both in terms of increasing revenues and also improving the cost-to-income ratio there. In the life and rural, the SH1 operation also showed a better performance in terms of combined ratio in addition to the increase in the earned premiums in the quarter year-over-year.

In year-to-date performance, we can see that net income increased significantly, the growth pace from the 1% that we saw in March year-to-date to 5.2% right now in June, with an ROE of 55% in the semester annualized.

So, moving to the page 5, we can see the performance of the financial results and the main drivers of this performance. So we can see here that net investment income grew by 3% year-over-year, accounting to nearly 29% of the net income for the quarter. As compared to the same period last year, we had some here tailwinds for the financial performance, like the higher average Selic rate and the downward shift move in the forward yield curve, as you can see on your upper right-hand side, where the yellow curves represent the beginning and the end of the second quarter this year while the blue one refers to the beginning and the end of the second quarter last year.

But on the other hand, we also had in this quarter some headwinds for the financials results like the lower IPCA in the quarter impacting the financial securities held to maturity, mainly the inflation protected securities that we have in the pension business. And here, specifically in the case of financial results, where seasonality does not play a big role, it's worth to comment on the quarter-on-quarter performance.

So, the 5% drop that we can see here was driven by the amplitude of the downward shift move of the forward yield curve this quarter, which was much higher in the first Q than was in the second Q and the lower inflation. That's why both the lesser amplitude of the downward shift move in the forward yield curve this quarter and the lower inflation have hit the performance of the financial result in the second quarter as compared to the first quarter this year.

On page 6, we will now begin the discussion by operating segment. So, beginning with life and rural, the SH1, in terms of topline, premiums written grew 12.3% year-over-year, boosted [ph] by term life as you can see, mortgage life and rural insurance, mainly crop insurance, here. The credit life dropped by 38% year-over-year. It's still weak, but much better than the minus 63% reported in the first Q. And retained premiums fell by 1.2% year-over-year and this is mainly a result of a strong rural with a higher share of crop insurance in this first semester and it's worth noting that when we talk about crop insurance, besides having a huge growth in premiums written, we retain just 20% of this risk because of the volatility, 80% is ceded to reinsurance.

So, because of this mix shift with a higher participation of the rural, mainly crop insurance among premiums written, we can see that retained premiums dropped by 1.2%, mostly because the lines that grew the most are the ones that we cede the most to reinsurance, so mainly crop insurance, that's because -- that's why the growth in premiums written was 12.3%, while retained premiums dropped by 1.2%.

On page 7, we can see the operating performance of the business. So, the solid line here represents the ratios calculated based on the managerial income statements that we show in our MD&A, while the dotted line represents the adjusted ratios, where we try to normalize the effect of the strengthening and reversing provisions to try to give you a better sense of the trend of the ratios. So, considering these adjusted ratios, what I mean the dotted line, we can see an improvement in the combined ratio, driven by lower claims, mainly in term life and credit life, and a lower G&A, which was partially offset by the increase in the commission ratio. Year-over-year, you can see, it reached 28% as compared to 26.4% in the second quarter 2015, which is not necessarily bad as our broker firm BB Corretora is receiving a larger share of these commissions. So this is totally very accretive for the business.

On page 8, we can see the improvement -- how much improvement combined ratio brought in terms of increasing the underwriting results, which grew 16% year-over-year, with a net investment income growing 14% year-over-year, driven mostly by the higher average balance of financial investments. And even though with a higher income tax rate, the social contribution that has increased last year in the third Q, last year, the net income grew by 10%, but if we were to set apart this effect looking at earnings before taxes and profit sharing, these earnings have grown 16% year-over-year in this quarter.

Moving to page 9, we are going to talk now about the P&C business. Premiums written dropped 1.8% driven by the weak performance in the auto insurance impacted by the reduction in the sales of brand new cars and a still challenging environment for this business in Brazil.

So when we look at this performance, with auto insurance dropping by nearly 18% while casualties have grown 17.4% year-over-year, we can see that we had as in SH1 a shift in the mix of premiums, including participation from lines that have a higher percentage of premiums being ceded to reinsurance. So retained premiums dropped at a faster pace as compared to premiums written. So, retained dropped by 9.2% year-over-year when premiums written dropped 1.8% which was totally explained by the change in the mix and increased share of lines with a higher share of premiums being ceded to reinsurance.

In the operating performance of this business on next page, considering the adjusted ratios here, as we discussed during the SH1 analysis, we can see a deterioration in the combined ratio mainly due to higher claims in auto insurance as a result of the higher frequency of robbery and theft in the quarter. But even so on a quarterly basis, the loss ratio has improved Q-o-Q from 64.2% in last quarter to 62.8% in this quarter.

Moving to page 11, we can see that the underwriting result grew by 39% as we had the reversal of the provisions for claims incurred but not reported after the spike in the loss ratio in the first quarter, which is totally normal when we look at the provision flows. Once we have a higher claims reported, we can do the reversal of the IBNR, provisions for incurred but not reported claims, as these claims will now be part of the provision for claims to be settled as these claims were already reported. So, this is totally normal, that's why when we -- after this spike on the loss ratio in the first Q, we had a reversal of the IBNR provisions in the second Q, pressuring [ph] these underwriting results by 39% year-over-year. In the net investment income performance, it has grown 26% driven by both, the expansion of the average volume of financial investments and higher average return on these investments, mainly due to the higher Selic rate in this quarter as compared to the second Q last year. And the net income here grew by 26% in the quarter with an annualized return on average equity of nearly 14%.

Talking about the pension business, we can see that the contributions amounted to BRL14 billion, 29.5% up year-over-year, with net inflows growing by 31% year-over-year, also helped by the 1 percentage point lower redemption ratio, dropped from 9.3% in the second Q 2015 to 8.4% this quarter. When we look in terms of reserves, it has grown 31% year-over-year, while management fees have grown 28%, while the average management fee dropped by 0.06 percentage points year-over-year, mostly driven by the focus that we still have on high-networthy-individuals in Banco do Brasil client base.

That's why when we look at management fee, the average charge is dropping year-over-year, but when we look at the total, the nominal revenue, it's growing 28% as compared to the second Q '15, driven mostly by the increase in the reserves as a result of a very strong performance in contributions and lower redemption ratio as compared to the second quarter of 2015.

When we look at this very good performance in management fee, growing 28%, a better cost-to-income ratio, we can see that the net income grew 15% year-over-year with a return on average equity of 39%, also impacted as the other companies that I've mentioned by, but increasing their social contribution, but if we were to set apart these effects looking at earnings before taxes, it grew 26% year-over-year. On premium bonds, on page 13, collections dropped 20% year-over-year, with bonds outstanding growing by 7.5%. So we can see here that the result of the strategy adopted to focus more on clients from the C and D income segments led to the drop in the average ticket for premium bonds. It's worth noting that we are about to launch the new portfolio of premium bonds, designed specifically with a huge concern on suitability of this product for clients of medium and high-networthy-individuals. So, we are about to launch and we believe that it's going to help the client to rebound in the second half of 2016.

But despite this drop in revenues, because of this focusing on lower income individuals, you can see that, it's important to emphasize, that it also came followed by a lower expenses and a strong net investment income, with the spread growing 0.8 percentage point year-over-year. And also it is worth noting here as I previously explained that the spread, when we look on a quarter-on-quarter basis, fell mostly because of the downward shift move in the forward yield curve, which was much stronger in the first quarter, it was very concentrated in the first quarter.

So, the amplitude of this downward shift was much higher than it was in the second one. As a result, the net income grew by 6% and looking at earnings before taxes, it grew 17% in the premium bonds business.

At the broker on page 14, we can see that revenues rose by 8% year-over-year, boosted mainly by pension plans and sales of term life and mortgage life insurance in SH1 in addition to the very strong performance in rural as I previously mentioned. In terms of profitability, the net margin remained flat year-over-year, while the EBIT margin dropped because of the change in the BB Corretora's tax regime from the cumulative to the non-cumulative system.

So, because of this change, that happened in March this year, taxes on gross revenue, so tax expenses on brokerage increased from 4.65% to 9.25%. So this led to a drop of nearly 1 percentage point in the EBIT margin that was totally offset in the second quarter by the strong performance that we had in the net investment income because of the higher average Selic rate. So, in this business, particularly we had a very conservative approach, but majority of the investments are composed of repos, totally tied to the Selic. When we look at net income, grew by 8% year-over-year, reached 420 million in this quarter.

And finally on page 15, we have our guidance for 2016. So year-to-date, our net income grew by 5.2% with a strong performance in the second quarter, pushing the growth rate from nearly 1% as reported in March to 5.2% right now.

Anyway, it remained below our guidance range that used to be 8% to 12%. So we (inaudible) But according to our estimate for the second half of this year, the 8% to 12% range is not feasible anymore. So, due to some factors that we could not predict when we built the 2016 budget last year like as I told you in the previous slide, the change in the tax regime for the broker in addition to the scenario of lowering interest rates by the end of the year, lower expected inflation and a weaker-than-expected sales of credit life, a higher loss ratio in the auto insurance, so all these are factors that we could not predict when we built the 2016 budget. Because of these, (inaudible) to revise our guidance for this year to 4% to 8% growth in net income, which we believe that's much more feasible according to the current scenario than the previous guidance.

Well, that's all, we can now move to the Q&A session. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Gabriel Pimentel from Bradesco.

Q - Gabriel Pimentel

First is about the positive effect from one-offs of reversal of provisions in SH2. Can you please give us more details about what happened? I think there was a couple of provisions there that we were not expecting to see a reversal of provisions.

And the second point is on financial results for Brasilprev, which had a weaker reading in the quarter. Can you please remind us what are the main factors that played in for this line? Thank you.

A - Rafael Sperendio {BIO 18963159 <GO>}

Hi, Gabriel, Rafael speaking. So, regarding to the results of the provisions that we had in SH2, mostly concentrated in the IBNR provisions amounted to nearly BRL84 million in the quarter. So, if you are talking about these provisions specifically the IBNR provision, we have a regular flow, that's [ph] normal for the business. We normally have when we build this provision of IBNR for claims that we expect to occur in the future, but were not yet reported. But we believe according to our statistical models that they will happen in some month in the future, that's why we build this provision already our expecting for these claims.

When we have a kind of a spike in the claims being reported to the company, we notice that these, I would say, forecast of claims that we had and that's why we built the IBNR provision, they are now already being reported as we expected. When it happens, how far the dynamics works? We increase the provisions for claims to be settled and we reverse the IBNR provisions. As now these claims were already reported, it doesn't make sense, it does not make any sense to keep the IBNR provisions because we are now already building the provisions for claims to be settled. We already know this is sure, it is not an estimate anymore.

So these builds [ph] are totally normal every time that we have a spike in claims being reported, we will have a reversal of the provisions of IBNR and it can be even in the current quarter or in the following quarter. Another effect that impacted here is that, we -- normally every semester, we do a deep review in our statistical models, in our actuarial models and we -- in the specific case of the auto insurance, we have identified that the recovery ratio that we were using when we were building the IBNR provisions was well below the historical patterns that we had in terms of claims recovered. So, we updated this ratio and that's also led to a reduction in the IBNR provision. So, both these effects combined led to this 84 million reversal in the provisions of SH2 in the second Q.

Just moving to your second question regarding the financial results at Brasilprev, Brasilprev has a totally different dynamics in terms of financial results as compared to the other companies within BB Seguridade. And this business is particularly what is driving financial results, there is the defined benefits plan, remember that it's no longer sold, we stopped selling it in 2002, but we still have a portfolio there that is also driving the financial results of Brasilprev in addition to the company's own reserves, but most part of the financial results comes from the defined benefit which in this trend specifically, we have the liability tied both to IGP-M inflation rate and the TR rate.

So, as we have a long -- consider a long-term liability tied to inflation, the vast majority of our portfolio is also invested in inflation protected securities. Because of these dynamics what happens is when we look at the liability side, as I mentioned, we have IGP-M and TR, IGP-M is nearly 70 plus, but on the asset side, nowadays it's very hard to find IGP-M securities to buy in the market. So we have a part of the assets invested in NTN-C that's inflation-protected securities tied to IGP-M.

And we are now buying the NTN-B that is tied to IPCA because we do not have IGP-M securities anymore to buy in the market. Because of this difference in inflation ratio, what is driving the result in certain part of the Brasilprev, the financial result of Brasilprev is this spread between IGP-M where we have as a liability and IPCA that we have in the assets. So, every time that IPCA goes above IGP-M, this is positive for financial result. If we have the opposite effect when IGP-M goes above IPCA, this is a negative impact for the financials results of Brasilprev. This is -- I do not know if I make myself clear, but this is more or less how the dynamics of the financial results of Brasilprev looks.

Q - Gabriel Pimentel

Yeah, that was perfect, it was very fair explanation. Thank you very much, 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>}

Thank you all then for joining the conference call for the second quarter earnings. It's worth to remember that second quarter played a very important role in terms of bringing this growth rate from 1% that we provided in March to now 5.2%, it's worth to highlight.

If we did not have the change in the tax expenses at the broker, the growth rate in net income would be around 7%. So, because of all these factors that we did not expect when we planned the guidance when we were building -- when we built the budget for 2016, we had to revise the guidance range from the previously 8% to 12% to now 4% to 8%, mostly because of these unknown expected events, but the company is still showing a very good performance and still believe that we are going to be able to be within this guidance and close the year having a very good growth rate for earning and also delivering good performance for our shareholders. Thank you very much. Have a good day.

Operator

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