# Q2 2017 Earnings Call

## Company Participants

- Rafael Sperendio, Head of IR
- Werner Romera Suffert, CFO

## Other Participants

- Guilherme Domingues Costa, Analyst
- Thiago A. Kapulskis, Analyst

## Presentation

### Operator

Good morning, everyone. And welcome to BB Seguridade's Second Quarter 2017 Earnings Conference Call. This event is being recorded. (Operator Instructions)

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 go ahead.

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

Good morning, everyone. And thank you for joining our Second Quarter earnings call.

Beginning our presentation on Page 3. We have here a brief overview of what happened in the quarter. So net income was down 12% year-over-year to BRL 956 million on recent financial results. As you can see on the lower hand side here, we see that the financial results dropped by 22% year-on-year. And this was already expected due to the falling interest rates. We are going to cover it on next page.

The noninterest operating results fell 8% year-on-year, driven by weaker commercial performance, mainly in pension premium bonds and credit life. But on the other hand, when we look at the operating papers of all the companies, we saw many improvements and we'd like to highlight here the improvement that we had in the insurance business, mainly in SH1 or the life -- mortgage life and rural business. But we actually had improvements in the loss ratio for the P&C business as well.

In pension trends, the net income grew 7.6%, thanks to the 0.2percentage point decline in redemption ratio and the 25% increase in the assets under management.

And lastly, our Board of Directors has approved BRL 1.6 billion distribution of dividends related to the first half 2017, maintaining our practice of paying out 80% of the net income.

On Page 4, we have a brief summary of the main variables that affected our financial results. And the most straightforward one, on the upper left-hand side, the reduction in the average Selic, down from 14.15% in the Second Quarter last year to 10.93% in the Second Quarter 2017. We also had some impact coming from the forward yield curve, which, last year, presented a deeper downward move as compared to the ones seen year-to-date. And it's worth mentioning that in the Second Quarter this year, we even saw an upward move in the longer maturities as compared to March, for example. And it implies that the mark-to-market on fixed securities helped the financial results in Second Quarter 2016 but did not help that much in the Second Quarter 2017.

The lower inflation also includes some pressure in financial results provided the lower return on inflation-protected securities classified as held to maturity mainly in our pension plan business that we have the assets that are already collaterals defined as benefit trends. Mostly the -- most part of the interest component comes from the inflation-protected securities. And that's why it had some pressure in the net income of the pension plan business, as we are going to see later in the presentation. As a consequence, financial results were down 22% year-on-year, accounting for 26% of the net income. And now back to a more normalized level as we were always emphasizing things, the company became listed in 2013, that normalized contribution of the financial results to the net income should be around 0.25.

On Page 5, we are going to cover the performance of each business segment from now on. So for SH1, premiums were down 7.7% year-on-year, driven by credit life, which was down 41%; and DPVAT down 36%. Later, hopefully explain it. Just to remember, this is a medical insurance, almost 0 margin product. That airway driver has to pay here in Brazil. And the price of this medical insurance was down 37%. So the decline was totally in line with this decreasing price.

On the other hand, term life rebounded from the 3% decline that we saw in the first Q this year to a 3% growth in the Second Quarter. And in the semester, almost flat year-on-year. And overall, we've maintained a good pace, growing 17% year-on-year in this first half. So pretty much in line with our (inaudible) mates.

Moving to Page 6. We have the operational performance of these business segments. So as I mentioned in the beginning of the presentation, the loss ratio came down from 31% in the Second Quarter last year to 27% in the Second Quarter 2017, thanks to the robust performance in the rural insurance. It's worth mentioning that this year, we didn't have any major issue related to climate changes, like El Nino that we had last year.

And the G&A was up from 9.8% in Second Quarter to 14% this quarter on additional provisions for past due premiums, which amounted to BRL 19 million while in Second Quarter last year, we had a reversal of BRL 29 million related to the same provision. So there is hard hope here. And that's why despite the improvement in the loss ratio, the combined ratio deteriorated slightly, plus 0.6percentage points as compared to the

Second Quarter last year. But year-to-date, the combined ratio keeps improving as compared to the same period last year, down from 70.9% to 70.6%.

Next page, we can see that this reduction in the loss ratio helped the underwriting result to grow 10% year-on-year in the second Q and 15% year-to-date. So very good performance in terms of the underwriting in SH1, mostly driven by the decrease in the loss ratio.

The 24% drop in the net investment income and the additional provision for past due premiums that impacted G&A, these 2 effects drove the net income down 3% year-on-year in Second Quarter. But anyway, year-to-date, the net income remains flat despite the lower financial results.

On Page #8, we're going to start to file the P&C segment. So premiums written were down 5% in the Second Quarter year-on-year. But the segment specifically, it's worth reminding that the strategies that we have been adopting, we have been much more selective in terms of the risk that we are accepting in properties overall. But mainly in medical insurance. And for sure, that -- it has an impact on sales.

But on a flip side, it brings some improvement in the loss ratio. As we can see on the next page, the loss ratio reached the peak in the Fourth Quarter last year and has been falling quarterly. And year-to-date, it is 260 bps down already. And this reduction in the loss ratio is helping the combined ratio, which is on a downward trend as well, approaching the level of 100%.

On Page 10, we can see that considering these improvements, net income rebounded from a net loss in the last quarter and reached BRL 61 million in the Second Quarter this year.

On pension plans, Page 11 here. Contributions reached BRL 9 billion in the Second Quarter 2017, now 35% year-on-year. But it's worth mentioning here that we have harder comparables compared to the other players. And despite the fall in contribution, our market share was slightly above 1/3, which is a fair market share. And it's even higher than the one that we have in terms of assets under management. I mean, that even with contributions falling, we have been capturing a large portion of inflows than the one that we had in terms of AUM. So we're still increasing our market share in AUM. Redemption ratio came down from 8.4% to 8.2%. And assets under management grew 25% over the last 12 months.

Revenues with management fees increased 21% and helped net income to grow 8% year-on-year despite the weaker trend for financial results due to lower inflation, as I explained on Page #4.

The return on equity increased from 39% to 40.1% on a quarterly basis and from 37% to 41% when we look at the year-to-date figure. So I see we're up pretty good performance in terms of returns and growth in net income for the pension segment.

On Page 12. In terms of premium bonds collections, we're down 39% year-on-year, driven by weaker sales performance being in the single payment bonds, which are the ones that have the higher average ticket. But we said that -- in First Quarter, I would say, we have been seeing some improvement. The performance in June was pretty good, almost 40% up as compared to the performance year-to-date May. So we have been seeing some improvement. And as for July and for August, the performance was pretty much the same. And we believe that we are going to see some rebound performance of this segment throughout the second half this year.

Financial results dropped to 53% year-on-year, as expected, due to the fall in interest rates. And net interest margin came down 230 bps. And this is essentially spread through the business. The net income came down 56% in Second Quarter, 38% year-to-date. So pretty much in line with the decline in the financial results.

On Page 13, we have our broker. So as a result of the tough sales performance, brokerage revenues were down 17% in the Second Quarter year-on-year, driven mainly by the performance in pension, credit life and premium bonds. And had a direct impact on net income, which came down 18% year-on-year.

And finally, to wrap up this presentation, we have our accountability with the 2017 guidance. So year-to-date, net income is up by 4.7% year-on-year compared to the range of the guidance that grow from 1% to 5%. And when we published the guidance in the beginning of this year, going back to February, we were already expecting a tough first half. But with a gradual convergence to the growth range of 1% to 5% throughout the second half. This was totally in line with the expected gradual recovery of the Brazilian economy. But the main point is that the level of the uncertainty regarding the pace of this recovery in the second half has increased in the first half this year.

So while financial results, we feel further pressure; and the expected average interest rate for 2017 has been decreasing since we published the guidance for 2017. And based on all these changes in addition to the weaker-than-expected sales performance in the first half and the reduction in the ownership at IRB after leasing last week, which was not expected in our budget. So we are going to have less equity income coming from IRB from now on, we decided to revise the estimates for the net income growth in 2017 to minus 5% to minus 1%. Of course, we remain very committed to have a second half much better than the first half by deploying some initiatives that we have.

We can have some control like the commercial performance, as an example. In the first half, we tested an incentive program based on the variable compensation to the distribution network in order to raise some incentives to then to sell insurance products. And to make it clear, this variable compensation was not monetary. It was based on points from the loyalty program developed. And these points, they can be used to pay like energy bills, credit card bills and et cetera. They're not direct related to money. But indirect.

So in the first half, the task of this model is just to realize how sensitive the distribution network is to these incentives. And now in the second half, we are going to put more interest [ph] in this program in order to maximize the commercial performance. So we are going to lower the bar now as we have some more -- we get -- have a better sense of how sensitive the distribution network is. And that's why we feel confident on our recovery in the second half. And it's worth mentioning that this year, we are not going to have the bank strike as the last year agreement will last until the end of this year. So this is going to have a good impact on the sales performance in the second half as well.

So that's all I want to highlight. And now we can move to the Q&A session.

# Questions And Answers

## Operator

(Operator Instructions) Our first question comes from Guilherme Costa with Itau BBA.

## Q - Guilherme Domingues Costa {BIO 17950499 <GO>}

My question is about your perception for 2018. I know that you will not provide any guidance by now. But could you indicate what are the products you imagine will show the highest growth for 2018? How do you plan to deal with the even lower average monthly report rate? And could you also give us an indication of how much do you believe the bottom line could expand in a normalized scenario of stable monthly report rate subject to the expansion and controlled inflation?

## A - Werner Romera Suffert {BIO 18657101 <GO>}

Thank you for your questions. First of all, I'll emphasize that we don't have already the guidance for 2018. But we can talk a little bit about the trends that we can see. And of course, as you mentioned, the Selic rate will continue to drop throughout the year. So the new level of interest rate in Brazil, we believe that is good for our insurance operations. So as a trend, we will have a better scenario for all the products that we have to sell to our clients.

So with growing unemployment rate and a better economic environment, this will provide the kind of scenario that will help the growth for the Seguridade products. So of course, the first impact that we have is the reduction in the Selic rate. So the financial results will drop. And that the trend that we are looking throughout 2017, it will continue next year. So 2018, we'll have an average Selic rate that will be lower than the one that we have in 2017. But on the other hand, we will have a better commercial performance driven by this better scenario that we'll have and also some new initiatives that we have in place in all our companies to improve the operational side of the performance.

So it's important to mention that the operational performance is improving. So our operational results increased 0.5% year-to-date. So this is important to emphasize. And our goal is to continue this trend. And with higher top line growth, this will help us in moving this -- increasing this number even further. So this is our goal. The trends -- and it's important to mention that our main goal is to build the kind of operation that will increase the results in the long term. So we -- our focus is to have a recurrent -- the recurrence of our results being bigger year-over-year. So this, of course, we are in the middle of the strongest economic crisis in Brazil. But after this moment, we will have a better scenario for all our products. And we are quite confident that we'll be able to improve the results of our operation.

## Operator

(Operator Instructions) Our next question comes from Thiago Kapulskis with BTG Pactual.

## Q - Thiago A. Kapulskis {BIO 19187926 <GO>}

I have a couple of questions. So the first one is related to the incentives, right, because I remember in Q1 that sales on Brasilprev were quite strong, right? And some sales on SH1, especially life insurance, was not coming so fast, right, in terms of growth. But now we see Brasilprev sales coming in quite weak this time around and some recovery on life, right, the life insurance.

So my question would be, how should we look going forward, right? Because you guys mentioned the incentives that have changed, right? So how should we see? Should we see a recovery in -- on Brasilprev? Or you expect that not to happen, right? So that will be my first question. And my second question is in terms of capitalization, right, which we still see an important shrinking in terms of sales, right? Should we see more of that and why, right? I understand that there might be a revamp in terms of products, right, because of the Selic going down. But I would like to hear a little bit more about that.

## A - Werner Romera Suffert {BIO 18657101 <GO>}

Thank you, Thiago, for your question. First, the first question regarding the incentive that we have in Banco do Brasil channel. It's important to emphasize that throughout the first half of this year, we changed a little bit this -- the metrics that we have. And we split this initiative in 2. So we have now the Brasilprev and Brasilcap. So our pension plan business and premium bonds business in one metric and insurance, they are in the other metric. So doing this -- and we did this during the month -- it was March 2017. This change rebalanced the performance from Brasilprev and SH1, which was completely different from the one we had in our budget.

So it was important to change this and rebalance through the -- throughout the first half of this year. And now we believe that we are in the right page. So of course, comparing with 2016, the performance of Brasilprev was lower than -- the premium bonds company was lower than the one that we had last year. But we reached in 2016 our historical -- the all-time high of our premium performance -- our contributions performance. So we reached more than 50% of the net inflow of the market and close to 50% of the contributions. So it's not our fair share of the market. It's important to mention that we have strong players in this segment. In all this, really, they are trying to find ways to improve their contributions and the net inflow also. So it's -- and now we are believers in the segment and growing now our reserves more than 25% year-over-year.

And this is our goal: to continue this growth trend with strong numbers coming to -- from all the business. The pension plan is improving quite well. And with these changes that we implemented during the first half of 2017, insurance also, we've had a very good performance. So this was the change that we have in incentive. Not a huge change. But it was important to rebalance the growth coming from all the business that we have and as a consequence, to have more recurrence coming from all the business together. So this is the explanation about this change.

## Q - Thiago A. Kapulskis {BIO 19187926 <GO>}

Okay, okay. Very good. And what about -- yes, sorry.

## A - Werner Romera Suffert {BIO 18657101 <GO>}

About premium bonds, capitalization, we have also last year some segments, they were not selling the product because we didn't have a specialized -- or a product that we were able to believe to have delivered for this segment. So for example, (inaudible), the upper part of Banco do Brasil retail banking clients, they now -- they have products to buy. And so last year, they were buying products from the retail banking side of our company. So with more -- and also products to small and medium companies that we have now in our portfolio. We launched this in 2017. And they were using products from the individual plans. So with this growth now, we are having better performance.

The numbers from June are very good. And comparing with May -- all the months from 2017, it's increasing very well. And the trend for premium bond is a very strong performance throughout 2017. So this will reduce the gap in the budget that we have and of course, will build the contributions that will be enough to get the -- to increase the financial results of the business, not in terms of spread because the spread is decreasing. And that's the trend when the interest rate is reducing. But with higher provisions, we will be able to capture more results in Brasilcap. And also, it's important to mention that this business is one that provides a lot of commissions that flow through the broker. So we will have a positive trend also in the broker level, with growth coming from premium bond company, Brasilcap.

## Q - Thiago A. Kapulskis {BIO 19187926 <GO>}

That's very clear. Let me just do a follow-up, taking advantage that you mentioned the broker. So the broker, we should also expect better commissions going forward and not only in cap but in other lines as well?

## A - Werner Romera Suffert {BIO 18657101 <GO>}

Yes, Thiago. This is the trend with higher -- with premiums improving in SH1, SH2 and mainly also Brasilcap and Brasilprev, these commissions will continue to increase in the broker level. And this is the trend for 2017. And this is the trend that we are trying to push and to remain the main trend for 2018. So our goal is to improve this top line growth that will be very important to improve the results and our net income for 2018. So this is the trend. And we are working very hard to increase this as much as possible and as soon as possible.

## Operator

(Operator Instructions) This concludes today's question-and-answer session.