Q1 2017 Earnings Call

Company Participants

- Rafael Sperendio, Unknown

Other Participants

- Gabriel Gusan, Research Analyst
- Thiago Bovolenta Batista, Research Analyst

Presentation

Operator

Good morning, everyone. And thank you for waiting. Welcome to BB Seguridade's First Quarter 2017 Earnings Conference Call. This event is being recorded. (Operator Instructions) The presentation is available in the financial information section of BB Seguridade's IR website at www.bbseguridaderi.com.br.

Before proceeding, let me mention that forward-looking statements that may be made to during this conference call regarding expectations, growth estimates, projections, 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; 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 earnings call to discuss the First Quarter results.

So beginning on Page three here, we have the main highlights of the quarter. Our net income of BRL 993 million, which grew 4% year-over-year with a return on equity of 47%. And here, we can see that there were no surprises at all. So we were already seeing in our last earnings call and we discussed that the results of the 2016 fiscal year, we were already saying that we should expect the following interest in the financial results in 2017, which we expect that we will be able to offset with an improving performance the noninterest operating result. And this is what happened in the first Q. You can notice that our growth in net income was totally supported by the noninterest operating performance, which more than offset the decline in financial results. And the main force of this improvement in the noninterest result, I can highlight some of them being the first one, the decline in the loss ratio in our insurance operation. So it was almost across the board. And all of the -- overall, the most important business lines that we have in the insurance segment, all of them, they showed improved loss ratios.

And when we look into our base of business, we kept seeing the same highlights of the quarter as it was in 2016 and 2015. So a growth in gross deposit of 27% with a very good performance in terms of redemption. So our redemption ratio declined by 1.1percentage point year-over-year. And our net inflows reached 39% of the total in the market in the First Quarter. So then the main outcome of all these movements, we can see that we reached BRL 209 million in assets under management and a growth of 33% over the last 12 months.

So -- and also, it was really important to emphasize the contribution to the growth in the noninterest operating results. It was the performance of our brokerage segment. So it's equal to a solid revenue growing by 9.5% year-over-year. And this was a, as we said, we were going to cover it modestly in favor but mainly a result of such a strong performance in rural and some very good performance in pension plans as I've mentioned.

Moving to Page four here, here we have this discussion about the performance in the financial results. So as I told you in the previously, there were no surprises, as we were already saying before. And considering the most important of, say, moving parts that have some influence to our financial results, we can see in this page the decline in the average SELIC rate from 14% to 13% in the First Quarter of the year.

We saw a movement that was not expected before, which was a downward shift in the forward yield curve during the First Quarter. It helped somewhat, mainly the premium bond segment to offset partially this reduction in the SELIC rate with a positive mark-to-market effect in our fixed portion of our investment portfolio. But anyway, considering the magnitude of the downward shift, it was much smaller as compared to the one that we saw in the first Q last year.

And we also had the impact of a lower inflation rate. It has a direct impact in our inflation-protected portfolio held to maturity. Most of these portfolio is held by Brasilprev. And we have some small part of this in premium bonds. And the combination of all these effects we can see, in the combined net investment income, which dropped by 10% and accounted for 30% of the net income of the company.

So things -- when the BB Seguridade became public, going back in 2013, we were always saying that normalized level of contribution of financial results to net income should be something around 1 quarter. So that's considering the scenario of high interest rates that we just experienced, we've reached something close to 30% to 32%, even more in the first Q last year at 34%. But now, considering the trends that we have been seeing in the economy, we believe that's going to convert to this 1 quarter that we find that's more reasonable for the business model that we run in actively BB Seguridade.

On Page 5, we are going to cover here in more details the performance of our business lines, the most important ones. So starting these slides, market slides and overall premiums, we can grow by 9% year-over-year, driven by rural, which grew 51% year-over-year. And the reason here was because of the earlier release of the working capital loans for the summer crop 2017, 2018 that happened even earlier as compared to the First Quarter last year, when the bank started to forecast working capital loans in February, March, this year started in January.

So breaking down the performance of this -- commercial performance of the rural, we can see that, of course, crop insurance is the one that accounts for the most part of the premiums and grew 90% year-over-year. But rural lien and credit life for farmers, which are the ones that provide the highest margins in rural. They also saw very good performance at rural lien grew 10% year-over-year. And credit life for farmers, 37% year-over-year. But on the flip side, we had a weaker performance in term life and credit life as well, which declined by something close to 3% year-over-year.

On Page 6, talking about the operating performance of this business segment. We had a very good performance overall, with an improvement of 100 bps in the combined ratio, thanks to reduction in the lower -- in the loss ratio, mainly in rural and in credit life as compared to the same period of last year. And it's worth noting here that you can see these dashed lines. We had an accounting movement here, which impacted the loss ratio and the G&A ratio in the First Quarter 2017. The dashed lines showed the more normalized trend of these ratios for the First Quarter. And what happens here, this quarter, we reviewed our database of reinsured operations and also resulted methodology that we used for the impairment of reinsured claims to be settled. And as a result, we had a postdate effect of BRL 97 million coming from recoveries, which helped the loss ratio because there is meaning from reinsured operations due from past period.

But on the other hand, we had an additional impairment expense of BRL 94 million for receivables coming from the insurance that we haven't been able to collect until now. And they are due over 180 days. So we don't believe that -- we have not seen any kind of issue in receiving these provisions from -- sorry, receiving these receivables from our reinsurance, which are our partners, IRB. Meaning, IRB and Mapfre, we have an even economic stake at IRB and Mapfre as our partner in our SH1. It has an economic stake at Mapfre. So they are our partners. We have economic faith in both of them. So not a matter of default. But it's more a matter of following the regulation and reviving all the process of charging and issuing the bills to receive these money from these reinsurance companies. So we are not afraid. Probably throughout the year, we are going to be able to reverse part of these provisions. But we can consider that these are 2, even as they are growing or not. But we did not segregate from our P&L because we believe that they override each other. So the impact to the bottom line is close to 0. So that's why we decided not to segregate. But anyway, the dashed lines they show what we expect as more normalized trends for these 2 ratios.

Moving to Page 7, we can see the outcome of all of these dynamics. So the improvement in the loss ratio, more than offset the increase in the commission ratio that we saw in Page 1. That slide of the underwriting results grew 20%. But as the G&A ratio increased and we also saw a weak performance in the financial results, which declined 16%, both of these impacts. They drove the net income to a growth of 3% year-over-year and a return on average equity of 46%.

Moving to P&C. Premiums written increased by 1.7% year-over-year. And we see here it's totally driven by the casualties segment and the auto channel. Auto insurance was down from 1.4%. We're still impacted by the customer and the continuance as following the sales of manual cars. And we intend to continue with a more conservative approach with the underwriting fees and the regulation claims until the recovery of the economic activity happen. So still very tough environment and very competitive.

On to the operating performance of this segment on Page 9. We can see that the combined ratio deteriorated slightly, something around 30 bps. But what we can see is the main positive highlight of this business segment was the decline in the loss ratio. It happened even in the auto insurance. And we saw the marginal improvement in the loss ratio. But on the other hand, just on increasing the commission ratio, mainly in independent broker channel and an increase in the G&A ratio, coming mainly from strengthening provisions for reinsurance operations that were not set out yet. We can see that even here in SH2, we also saw these dashed lines, we had the same movement as we had in SH1. But in a much smaller scale. But the reasons, they were the same as I just explained before is insurance.

And Page 10, we can see that the outcome of this dynamics, the writing results grew 20% as a result of the improvement in the loss ratio. But considering the fall in the financial results in addition to the increase in the G&A ratio for this company, we have the -- in the First Quarter in 2017, a net loss of BRL 5 million in this operations.

On Page 11, the scenario here was completely different. Contributions grew by 27% to BRL 10 billion. The redemption rate was down 110 bps to 8.1% in the quarter, annualized basis. And as a result, net inflows reached BRL 4 billion, 20% up year-over-year. AUM reached BRL 208 billion, 33% higher in performances. Management fees grew by 33%. And the average management fee keeping this downward trend. And I already expected it, up 1 to 2 bps per quarter because of the mix on higher concentration of high network individuals, reaching 1.13% on an annualized basis in the first year.

Then -- it's worth highlighting that the dynamics came up being very trivial here with revenues growing at the same pace of the segment called reserves, even though the average management fee declined. But it can be explained by the methodology that we used to cap rate the average management fee, which is based on the average balance of AUM and not the balance in the end of the period. So what happened here was the average balance grew at a slightly higher pace as compared to the balance in the end of period, that's why we saw here in the upper right-hand side, you can see this 33% is considering not the average balance. But the balance in the end of March 2016, the average is the balance in the end of March 2017. So this explains why the management fees is growing at the same pace.

Anyway, we saw -- expect this very good performance of the operating performance, I would say, at Brasilprev, with also an improvement in the cost to income ratio. But on the other hand, we saw a decline of something around 26% in financial results. That's why the net income grew 11% year-over-year, while keeping very good level of return on equity, we reached 40% in the First Quarter.

In premium bonds, Page 12, we see that collections dropped by 10% year-over-year. And explained by the lower average ticket and the reduction sales of Mapfre payment bonds. We can see that in this business, a reduction in collections, which impacted the volume, along with the compression in the net interest margin, as we can see, from 8.3% to 7.4% in the First Quarter of the year. These effects drove the net income down 23% in the First Quarter 2017. But it's worth mentioning that even in this tough scenario, we still have been able to deliver something close to 100% return on equity in this business.

On Page 13, at BB Corretora, we can see that brokerage income grew 10% year-over-year, boosted by the strong sales in rural, in pension plans. But also helped by the accrual of earning commissions in credit life, mainly, in term life sold in previous period. And bottom line here, the 9% increase in the net income, which is very close to noting that in the first Q 2016, we had a hard comparable due to the increase in PIS and COFINS tax expenses in Brazil that changed in March last year, from 4.65% to 9.25% for the issuance brokers in the country. So despite this change, we are preparing a quarter fully taxed at 9.25% with another one taxed 2/3 of it taxed at 4.65%. Even with these differences, we managed to deliver 9% increase in net income year-over-year.

And finally, to wrap up the presentation, we have the guidance of 2017. We have an forecast for net income growth of -- from 1% to 5%. And we reached 3.7% in the First Quarter. So we'll be in the guidance as we expected.

So that's all I want to emphasize about the performance in the First Quarter this year. And we are now open to the Q&A session. Thank you.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Thiago Batista with Itau BBA.

Q - Thiago Bovolenta Batista {BIO 15398695 <GO>}

I have just one question this time about the SH2. It was a surprise for us, the negative results. If I'm not wrong, it was the first negative result in the last couple of years. So my question is what the company is doing? Or what the company can do to try to revert these losses? And also I believe no one are really expecting a good profitability of SH2. But neither those losses. So my question is, is it possible to revert these negative results of SH2 going forward? Or the mask situation is skewed at this for this business?

A - Rafael Sperendio {BIO 18963159 <GO>}

Thiago, Rafael speaking, thank you for the question. So you're right, it's the first time that we reported a net loss for this business segment in the quarter. We have been doing many operational changes in SH2 start of last year. And it's worth noting that considering the business environment for this segment, this is the one that presents the highest achievement to the macroeconomic environment. And what we saw in 2016 and the scenario remains the same in, at least in the beginning of this year, was the deterioration in the operation segment, which is the one that accounts for something, around 2/3 of premiums in this segment. So because of competition, because of the completely different in time as compared to the one that we have in SH1, this company runs at combined ratio pretty close to 100%. And now, even higher than 100%. So financial results is very important for this company. And we know this. And since last year, we were working very hard to improve the noninterest operating part of this business because of the -- and you already knew that -- that we hope that from now on, Brazil will go through a cycle with a very low interest rate and very low inflation. So we need to do something to offset the weak performance of financial results. We need to work in the operating part of the business to -- because we now cannot account anymore in the financial performance. So throughout 2016, we changed our underwriting model, mainly in auto insurance. We worked much more selective in terms of fees that we want to accept, regions that we do not want to have exposure anymore. And also, in the regulation of the claims process because in order to avoid fraud. Then it's normal in the environment that the country has experienced a higher unemployment rate. And also considering the fiscal situation of the states in the country and strikes that we had in the police in some states in Brazil. And in addition to this worsening environment for the segment, we had also, if I'm not mistaken, a 3 or four years in a row with a declining sales of brand new cars. So the fleet is becoming older and we're also seeing the frequency of robbery, theft and even fraud increasing since then. So we think that we are in the bottom of the cycle. We believe that things will start to improve going forward as the economics activity recovers, mainly in the second half. But it's worth mentioning that we can say that we are starting 2017 with our portfolio, making auto insurance with a much better quality as compared to the one that we started in 2016. And we can even see that in the performance of the loss ratio, already should show some improvement year-over-year, of course, it's marginally improvement. But stopped deteriorating. And we believe that it's going to be the trend for 2017 as we go. In summary, we need to work very hard in the business model and to work more in -- to be more selective of, say, in terms of fees that we want to accept, regions that we want to have exposure and terminals that we want to have exposure. So these are the main points we are working on. Of course, these things started already last year. But we believe that we are going to see the outcome in 2017 in 2018.

Operator

Our second question comes from Gabriel Gusan with Bradesco.

Q - Gabriel Gusan {BIO 16184494 <GO>}

My question is a very specific one. It's about the first part of '17 showing a different reading from usual when comparing the outflow of commissions from SH1 and the inflow of commissions into Corretora. This time, the inflow in Corretora was much larger than the historical. And the need between in-bank and external brokers doesn't help explain that. So my question here, do you have any color on what could explain these higher inflows in the Corretora?

A - Rafael Sperendio {BIO 18963159 <GO>}

Thank you, Gabriel. Rafael speaking. Considering this change, it's worth mentioning that, of course, these 2 lines, they are correlated. But they are not perfect correlated. And why? Because the income statement, the balance sheet, they are not prepared at the same time. So sometimes we have some movements that we already insure with the broker that were not reflected yet in the insurance company and the opposite's the same. So it's not going to be the same every month of every quarter. So we have some these metrics in terms of one, we chose the balance sheet of how these 2 companies, maybe this is something that could help to explain. And also, when we look at the acquisition costs at the insurance company, it reflects not only the expenses related to commissions, say, through the broker. But reflects all the expenses related to the selling process, it can be in the marketing expenses, investments in bringing the products or even the prices that we pay to distribute, to independent brokers and so on. So this not only related to the commissions that have some other moving parts that we need to take into consideration besides this nexus that we have when we prepare all the financial statements of these 2 companies.

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, one more time, for joining our earnings call.

And to emphasize what we have been saying that 2017 is a transition year. So we have a big challenge this year, which is to offset the following in financial results with the improvement in the noninterest operating result. And this quarter, the commercial performance was quite concentrated in rural and pension. We recognize it. In fact, we take to some very good opportunities that we had. But throughout the year, we intend to have a more balanced increase of sales but keep focusing on the most profitable businesses as we always have been saying like life, credit life, rural and pension.

But anyway, it's worth noting that low interest-rate environment with inflation under control helps a lot in our business model. And it will be very hard to find a country that has a developed insurance industry that could reach such level of development in the environment with high interest rates or even high inflation. And we have already been seeing some signs of improvement in the economy. But we believe that this recovery should be gradual. And besides the scenarios of low interest rate being very positive to our industry in the long term, we will need to go through this transition period with a weak financial results until this recovery, the economy translates into a stronger commercial performance.

We feel committed to our guidance. It's still feasible. But not easy. But we believe that it's got to be we'll be able to face these challenges and deliver good performance throughout 2017.

Thank you. And have a nice 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. Have a nice day. You may now disconnect.