

Q3 2019 Earnings Call

Company Participants

- Rafael Sperendio, Head of Finance and IR

Other Participants

- Eduardo Nishio

Presentation

Operator

Good morning, everyone, and thank you for waiting. Welcome to BB Seguridade's Third Quarter 2019 Earnings Conference Call. This event is being recorded. (Operator Instructions). The presentation is available in the financial information presentation section of BB Seguridade IR website at www.bbseguridederi.com.br/en.

Before proceeding, let me mention that forward-looking statements that may be made during the conference call during -- 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 they 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. Bernardo Rothe, BB Seguridade's CEO; Mr. Werner Suffert, BB Seguridade's CFO; and Mr. Rafael Sperendio, Head of Finance and IR.

Please, Mr. Sperendio, you may now begin.

Rafael Sperendio {BIO 18963159 <GO>}

Good morning, everyone and thank you for joining our third quarter earnings call. Let's start the presentation on Page 2 where we have year to date drivers of our earnings this quarter. Our recurring net income grows 21% year-on-year to BRL 1.1 billion, supported by the operating results it was up 25% on the back of a very strong commercial performance in credit life and pension plans. Financial results grew 4% and helped by the flattening yield curve and still favorable inflation dynamics on defined and benefits pension plan that were really pressed.

Our accounting net income of BRL 3.4 billion, helped by the one-off capital gain that amounted to BRL 2.3 billion related to the sale of our equity stake in IRB in July this year.

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Regarding our commercial performance in insurance, comparing apples to apples on further analysis I mean by adjusting last year data to see the current business structure in our JV with MAPFRE, our insurance premiums grew almost 15% driven by credit life and rural.

All performance in pension plan stood out this quarter showing improvements across our different metrics. We can see reserve grew 14% in the last 12 months. Net inflows increased 3X year-on-year. Retention rate fell 90 basis points, it's now a -- it's all time low. And finally, here to summarize our performance in premium bonds, also did well. Top line grew 8.5% year-on-year during the first quarter.

Moving to Page 3 now talking about financial results and you can see the lower right hand side, financial results grew 4% year-over-year and accounted for 14% of our net income in a third quarter. So the all-time low contribution to the borderline since we started to fold the metric. And regarding the main variables that affects the financial results, we can see here the benefits side a decline in the average Selic rate moving from 6.4% in the third quarter last year to 6% in the third quarter 2019.

But this reduction in the average Selic rate was more than enough at that point to flatten the yield curve. As you can see here on the yellow lines, the light yellow line represents the beginning of the period. And the dark yellow bar the -- sorry the dark yellow line represents the end of the period. So while in this quarter, we had a flattening yield curve, the yield curve in the third quarter last year widened. So it got some mark-to-market gains mainly at Brasilcap our premium bonds company, which helped somewhat the financial results, but the main positive impact came from the inflation rate. So if you can see on the lower Left hand side. The IGP-M the blue line here, posted deflation in the third quarter this year, while we saw an inflation of 2.8% in the third quarter last year. And as you know, IGP-M is an important index that compounds our liabilities related to the defined benefit pension plans at Brasilprev.

So this deflation reduced the loss because of the liability in property improvement in financial result at Brasilprev.

Moving to Page 4 and talking about our insurance operations now. I'm going to focus on the pro forma figures. As I explained earlier, it's an adjustment we have been making in order to revise 2018 data considering the actual structure post reorganization occurred in the end of last year so in the third quarter premiums written grew 14% year-on-year and supported by credit life that grew 41%, helped by better lower loan origination with individuals.

Rural also did well, grew 15% year-on-year accelerated the pace of rural that we were showing in the end of the first semester. We have an improvement in -- across the different segments, crop issues was El Nino. Also, via linear, the credit life performance is the line there that offers the performance bonus that's also helping the commissions by the broker. So rural is an important highlight of the quarter as well. Life increased slightly the pace by growing 6% year-on-year in the third quarter, , you may remember that in the

end of the first semester, this growth rate was around 5% accelerated to the pace year-to-date September now to 5.5%.

On Page 5, you can see now Brasilseg also did well operationally here. I'm going to focus beyond comparable as we can see that the combined ratio of the chart of the lower right hand side, combined ratio improved at 10 basis point driven by the increase in the loss ratio now 2.6% bench points on the back of the lower frequency and severity of claim, the term life and in credit life. G&A also improved helped by the lower provision for receivable losses, but as you can see the chart in the upper right hand side the improvements in both loss ratio and the G&A ratio was almost fully offset by the increase in the commission ratio, which mainly related to the performance bonus that the insurance company might pay to the broker due to the outperformance in credit life the agreement that we reached with MAPFRE in 2018.

Moving forward now on Page 6, financial results 40% year-over-year given the lower Selic rate created and that change the accounting methodology related to the interest compounding on that provision for judicial claims to be settled.

As a result, we saw this decline 40% year-over-year on a pro forma basis. But anyway, when we look at the performance -- overall performance the decline in financial results was totally offset by the increase in net premiums at around 9% and by the increase in the combined ratio that I just explained. So the net income grew 11% year-on-year in the third quarter and reached BRL400 million.

Moving to pensions now on Page #7, we can see that contribution grew 44% year-on-year in the third quarter, reached BRL 12 billion. The net inflow increased three times to 233% to BRL5 billion. Retention rate moved down from 7.7% in the third quarter last year to 6.8% now. And it's at the all-time low. Assets under management now reached BRL 282 Billion and increased 14% over the last 12 months. Management fees improved 10% year-on-year, while the average management fee charges reduced by 6 basis points to 1.02%. The improvement in management fees in addition to the improvement in financial results that I mentioned earlier the net income 32% in the third quarter this year to \$331 million.

Regarding premium bonds now Page #8, collections were up 9% year-on-year. Financial results grew 4% given the wider net interest margin as you can see that was due to the mark-to-market gains that's related to the yield curve that flattened this quarter. As I explained previously this in fact let to bottom line to grow 2% year-over-year now in the third quarter.

Moving now to the broker Page #9, revenue were up 40% year-on-year and 22% when we consider a linear distribution of the performance bonus received at the end of 2018 across the different quarters. So the main drivers for the top line growth were credit life, pension approvals in premium bonds and the -- also it's important to highlight the performance done or achieved of a robust commercial performance in credit life and credit life for farmers. The EBIT margin decreased 1.6% points on an adjusted basis, and it was totally related to the mix of the products sold that was more focused on the high ticket products than it was in the third quarter last year. And as a consequence of the improvement to top

line and the improvement in the operational margin, the net income grew 43% year-on-year in the third quarter.

Now finally, the last Page, we have our guidance monitor. As we can see here, we decided to revise up towards the guidance through the bottom line growth that was 8% to 13% and we revised it up now to 13% to 17%. The main reason was the surprise another positive surprise we had in financial results, the data I just explained and the favorable dynamics in inflation and the flattening yield curve throughout the quarter. And when we consider that, when we analyzed the breakdown of the earnings with a growth of 15% year-to-date in operational results and a growth of more than 25% in the operational results year-to-date. The former range doesn't make sense anymore that's why we decided to revise the guidance upwards. Regarding the other two guidance as well, besides seeing the outperformance, we opted to maintain both guidance of written premiums and the growth in reserves because, at least the top of these-- the two guidance is still feasible that's why we decided to maintain as we expect that both indicators, might converge to the interval. So that's all I would like to emphasize and we can now jump into the Q&A session. Thank you.

(Question And Answer)

Operator

Ladies and gentlemen, we will now begin the question-and-answer session (Operator Instructions) Our first question comes from Eduardo Nishio with Banco Plural.

Eduardo Nishio {BIO 15333200 <GO>}

Good morning. Thank you for the opportunity and congrats for the results. A question on your guidance or earnings guidance. If we make the back of envelope calculation and how much you get for the fourth quarter? You get a number that is lower than the first few quarters in terms of earnings. I was wondering if it's being too conservative, given that the fourth quarter is typically the strongest quarter you have in the year.

And also, I'd like to ask you if you have any perspectives for 2020, as you have sold IRB, and I think earnings will be a bit more difficult to achieve without the unit. If you have any perspectives or ideas and how do you get EPS grow for next year? If the operational side will be -- would be good enough to offset that and also offset low interest rates? Thank you.

Rafael Sperendio {BIO 18963159 <GO>}

Hi, Nishio. This is Rafael. Thank you for the good questions. So regarding the guidance revision, it's worth highlighting that we are expecting to reach the midpoint. Where we decided to revise it, that's because as I mentioned earlier in the presentation, the former range doesn't make sense anymore when we analyze operational results growing 15% and financial results growing 25%. So well it's time to revise it upwards.

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Regarding the probability, the scenario that we have for the fourth quarter, well there is a higher probability that when we analyze the matrix that we are going to stay in the upward part of the guidance of course. But worth noting that when we look at the interval that we have been providing, the deviation from the midpoint is quite small, like BRL80 million up and down. So well, it's a very small interval and we decided to keep the 13 as we mentioned, just to be conservative. That's why we decided to maintain this range, because the deviation of the dispersion from the midpoint is very, very small.

With regard to 2018, sorry, it's 2020 earnings. Of course, IRB was an important contributor for earnings, it has contributed like 5% of our earnings, and we're going to have a hard comparison in the first half next year. But anyway, we do believe that the performance in financial results will more than offset this lack of IRB next year. But the main difficulty will come from again after three years in row, again from lower financial results.

Our expectation is that maybe when we analyze previously saw before in the yield curve that the Selic rate will be flat at 4.5% next year. And differently from what happened in 2019, we don't expect that we can reach mark-to-market gains from the flattening move of the forward yield curve. So it's going to make our life much harder in 2020 when we think about the performance in financial results. But anyway, we believe that we can more than offset it with a better operational performance, despite not having IRB now in our portfolio anymore.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I would like to invite Mr.Sperendio to proceed with his closing statement. Please Mr.Sperendio, go ahead.

Rafael Sperendio {BIO 18963159 <GO>}

I'd like to thank you all once again for joining our earnings call. And myself and the Investor Relations team, we are available for any further questions you might have. Thank you 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 BB Seguridade's Investor Relations website. Thank you very much for your participation, and have a nice day. You may now disconnect.

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