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Q4 2016 Earnings Call

Company Participants

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

Other Participants

- Aymeric Monod-Gayraud, Analyst
- Thiago Batista, Analyst
- Unidentified Participant, Analyst

Presentation

Operator

Good morning, everyone and thank you for waiting. Welcome to BB Seguridade's Fourth 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)

Before proceeding, let me mention that forward-looking statements that may be made during the conference call regarding expectations, growth estimates, projections, future strategies of BB Seguridade's are based on management's current expectations. Projections of the 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>}

Good morning. Thank you, everyone for participating in our conference call to discuss our 2016 results. So beginning here on page number three, we have main highlights of the company for the year. We have first one here our net income was BRL4.1 billion of 4.1% within our revised guidance upward to 8% growth in net income. It's worth (inaudible) EBITDA if we virtually set apart the effect that we're having changes in tax rates and social contribution and also in tax expenses and VAT had a bulk, we estimate that the net income would have been roughly 8% higher in 2016. So it was an external effect that

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impacted our results. And we also would like to highlight that these was not dependent on our operating performance. The second one our performance in a Life and Rural business segment, when if we look at these business specifically the adjusted net income grew by 2% while the earnings before taxes and profit sharing grew nearly 6%. We have very good performance in premiums written in Life, Rural and Urban, Mortgage Life, the only Life that was -- the only line that was weak in this business was Credit Life. And I'm going to cover it in more detail later. For P&C in SH2 our adjusted net income is 40% due to weaker net investment income and the higher loss ratio mainly in auto insurance. For pension plan -- that the main highlight for the year contributions were 28% with a lower redemption ratio leading to an increase of 28% in net inflows equivalent to 50% of the total net inflows in the Brazilian pension plans industry.

And the outcome here that AM [ph] reaching BRL198 billion with an increase of 33% in the last 12 months, for premium bonds, our net income grew by 16%, driven by higher net interest margin. While the broker, the revenues grew by 8% driven by the very good performance that we had in Life, Rural and Pension. And finally the last point that I would like to highlight here is the distribution of BRL3.2 billion as dividend equivalent to 82.3% payout considering the accounting net income.

Moving to page four, we have a brief summary of our adjusted net income, segregating the one off events. So we had two extraordinary events in 2016. The first one was the deferred tax assets of PIS and COFINS together VAT tax of MAPFRE at SH1 and SH2 of an outcome of the changing the methodology for calculating the tax expenses for these Companies. So if I were to summarize, we're moving from that cash basis methodology to the accrual base of methodology. So if result have been non-deferred tax assets of (inaudible) differences related to claims to be paid. Claims incurred. But not reported and claims incurred. But not enough before tax and when we look at the global and tax yield -- has may differ tax assets were impacted by provisions required in 2016, as well as in previous years. We segregated the portion related to the previous years with an extraordinary effects reached amounted to BRL23 million -- taxes.

The second event was the impairment loss related to the goodwill that we have in SH referred to SH2 its differed and may the holding Company that we call it BB Seguridades in total amount of BRL176 million of tax, BRL116 million net after tax. So these good will are both from the partnership with MAPFRE in 2011, that due to the deterioration in the scenario as compared to the one expected when the partnership was captured, we were first to the core this impairment now in 2016. As I mentioned in the first place setting apart the extraordinary events, our adjusted net income reached to BRL4.1 billion, 4.1% higher compared to the one presented in 2015, while the accounting net income was up BRL4 billion. And here is worth noting the distribution of dividends was not affected by the impairment in our payout ratio. As I mentioned previously, 82% was even higher than the 80% that you will -- be here with since the company has become listed.

Moving to page number five, we have brief of -- (inaudible) our financial results and its contribution to earnings show the combined net investment income grew by 3% equivalent to 31% of the adjusted net income. And the main (inaudible) that affected our financial results in 2016 was -- in the positive side, the highest average Selic rate as compared to 2015. You can see in the upper left-hand side and downward movement

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before yield curve, which brought positive mark-to-market effect in our fixed rate portfolio. And the flip side, we had the bottom left hand side, the decline in the inflation rates we've brought a negative impact on the accrual of the inflation-protected securities classified as held to maturity.

In page six, I'm going to cover the performance for BB MAPFRE from now on. So I starting the Life and Rural BB MAPRE SH1 premiums written fell by 3%, driven by Credit Life, which dropped 38% this year. On the other hand, we had a very strong performance in all the other products like term life grew 16% below range 14% and Mortgage Life grew 29%. Regarding the operating performance for the business, the loss ratio deteriorated slightly as compared to 2016, which a higher frequency of point in Credit Life in the Rural effects that impacted the Rural portfolio. We also fell an increase of 20 bps in the commission ratio for the year. And regarding G&A, we showed improvement of 1percentage point, which partially offset the increase in both the loss and the commission ratio.

And the outcome of these dynamics combined ratio resulted by 1.2percentage point in 2016. On page eight, we can see that the (inaudible) performance of the combined ratio, we managing to deliver 7% growth in the writing results come from the increase in the premiums earned. Net investment income was flat as compared to 2015. And the net income grew by 2% in 2016 with a return on equity of 44%. On page nine, we have this full performance for P&C. So premiums written dropped by 7% in 2016 impacted by the weak performance in (inaudible) insurance which declined by 18%. And in this segment specifically, we have been observing very difficult scenario due to the reduction in sales of brand new cars for the fourth year in a row, we went back to the same level of sales of new cars as we had eight years, nine years ago. And the frequency of robbery and theft, as we can see on the next page also will affected the loan ratio company which including by 4.5percentage points in 2016. And the Commission ratio increasing slightly, driven mainly by the independent brokerage channel. And the G&A ratio improved by 0.4percentage points but not enough to effect increasing loss in the commission ratio with flat combined ratio for these business to reach 104% in 2015.

On next page, we can see that the deterioration in the combined ratio throughout drop the underwriting results down to BRL200 million loss in 2016. While the net investment income dropped by 11% this year we had an -- I thought remembering that we had not combined ratio in 2015. So in 2015 we had the benefit of higher inflation and also some benefit coming from the change in the foreign exchange rate, which benefited the financial results for 2016. In 2016 given have the (inaudible) effect. Then the outcome here was the 40% decline in the net income to 2015 return on equity of 7% for the P&C business.

For Brasilprev in page 12, we can see the contributions had grew by 28% to BRL47 million, redemption rate was down 50 bps to 8.8% of the total assets under management and as a results here net inflows reached BRL29 billion and increase of 25% in accounting for 50% of the total industry as I mentioned in the beginning of the presentation. So the AUM reached $198 billion, 33% higher as compared to 2015. Management fees grew by 26% with the average management fee found downward 1 bps to 2 bps per quarter reaching 1.15% in 2016. In the main business here was the mix pretty much concentrated in high network results along with the dilution of the participation, we define it benefit pension

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plan in the assets under management. So the net income grew by 17% with a return on average equity of 42% for this Company

For premium bonds on page 13, we can see that collections dropped by 13% in 2016 extended by the decrease in the average ticket for (inaudible) time being increased by 7% and this is basically explained by the higher participation that monthly payment bounce, with half of much lower average ticket that's compared to the single payment. Net investment income grew 42% driven by the increase of 1.6percentage points in the net interest margin as a result of a higher average Selic rate as well as the downward movement of the forward yield curve which led to growth of 16% in net income despite the declining in the collections. Last two minutes (inaudible) I want to cover here BB Corretora on page 14, commissions grew by 8% this year driven mainly by the strong sales performance in Life, Rural and pension plans with contraction in demand margin here, this was basically explained by the increase in (inaudible) as I mentioned in the very beginning of the presentation from 4.65% to 9.25% for PIS and COFINS. The net income reached BRL1.6 billion, 7% higher as compared to 2015.

On page 15 we have our guidance for 2016. So as we already covered in the first page of the presentation the adjusted net income grew by 4.1% so the revised range of the guidance for the year. And finally, on page 16, we provide our guidance of adjusted net income growth for 2017,1% to 5% growth as compared to the adjusted net income reported for 2016. So we believe that 2017 is still a transition year, we expect a negative impact on the financial results due to falling interest rates along with the inflation rate converging to the midpoint of the target trend so -- for sure will impact our financial results in throughout 2017. On the flip side, we expect that the growth of our non-interest operating results we're more than offset the weak performance in financial results, especially in the second half we are, as we expect the coverage in segments that did not perform (inaudible) 2016 like -- as an example or even premium bonds. And that's why we ended up with the 1% to 5% growth range for 2017. So (inaudible) which finishes the presentation and we are now open for the Q&A session. Thank you.

Questions And Answers

Operator

Ladies and gentlemen we will now begin the question-and-answer session. Thiago Batista, Itau BBA.

Q - Thiago Batista {BIO 15398695 <GO>}

Good morning and thanks for the opportunity. I have basically two questions, the first one is regarding the pension business, could you comment about the outlook you have seen for this product. And if you believe will be possible to continue to outperform the market growth in 2017. And second question is about the potential launching of new products or (inaudible) or the remodeling of products in 2017. Last year, we saw a good impact in the sales of Life product following the remodeling that we did in this product. Is it possible to see any new product or any remodeling of products during this year?

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A - Rafael Sperendio {BIO 18963159 <GO>}

Considering the present performance (inaudible) for 2016, we expect the competitors will now (inaudible) more in Pension that (inaudible) in 2016 (inaudible) all the advantage that follows the discussions surrounding the pension industry in Brazil like the pension before. And the brokerage and realizing that they need an additional source for saving in order to -- as a Company very first to the retirement provided by the Social Security. So we had two benefits from this reform, people realizing that they need an additional savings and also they want to retire early then the what is proposed in the pension reform that expectations that it's going to be approved by -- maybe in end of this semester or even in the beginning of the next semester. And that if the people that are starting to contribute to the pension industry to (inaudible) 55% instead of 65% (inaudible) you have in additional source for the retirement. So the thing that all being the prior pension industry will take the advantage of these very close to scenario and now the news that's revolving the base on reform and this is going to be very closely. When we look at the market share that we have (inaudible) fair market share when we look in terms of contribution even in assets under management but in terms of net inflows, we reached 50% of the holding this (inaudible) in line with the market share that the fee as of fair market share. And when we look at asset under management for instance . So we expect that the industry will recover for pensions (inaudible) in line or slightly above the industry in terms of contributions that in terms of net inflows, we should bounce back to something around 30% or the one-third of the holding industry like we have in contributions in assets under management.

Q - Thiago Batista {BIO 15398695 <GO>}

So (inaudible) to answer the second question regarding new products that we have added last year and I would say that the main products that we added in 2016, the Life products. As you mentioned in premium bond products, we will capture this new premiums flowing from this new products just now in 2017, sorry, because most of these products was launched just in the third and Fourth Quarter last year.

A - Rafael Sperendio {BIO 18963159 <GO>}

So the impact that we will have, we will start more consistently from now on so, we don't have any other new product in the end of this year to face or to deal with this operational increase that we expect for 2017. What we believe is that we have room to increase this premiums growing from these products that we launched last year. And now the sales for us to understand this product, the new features that we have embedded in this product. And this will be increase the top line and with a better performance under writing risks and commercial costs that we have in this, acquisition costs that we have this product, which will guide you through better technical margins and increasing our operational results, how we are facing this transition year that will be in 2017.

Operator

Aymeric Monod-Gayraud, Bank of America Merrill Lynch.

Q - Aymeric Monod-Gayraud

It's actually Monod-Gayraud from Bank of America Merrill Lynch, two questions as well. The first one is related, going back to Brasilprev, if you can discuss a little bit about the competitive environment and the outlook for pricing, especially as the Selic comes down. If you would expect prices to come down as well. Second question is related to the SH2, what is the strategy here combined ratio well above 100%,105% throughout the year, what is the strategy to improve the results from SH2, that's it, thank you.

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A - Rafael Sperendio {BIO 18963159 <GO>}

Hi, Monod, thank you for question. I'm going to cover your first question. And then Werner will talk about all the strategy related (inaudible). So considering the outlook for pension in Brazil, we have 1.15% as the average management fee like now. But when we look at the average Selic rate from an (inaudible) something around 13.8% in 2016. So

the (inaudible) for 2017 between maybe single (inaudible) by the end of the year may be 10.8% of the average that we expect that before, the industry will be the pressure to reduce management fee (inaudible) natural and very expected movement. And what we will try to do is not just lower management fee but change that way that we are managing the assets. So we have to raise in the segments. If we keep just managing fixed income. We do not having more (inaudible) while under dense reduce management fees but if we move and we add more value to the investors in terms of increasing the determinant on the (inaudible) diversification or even we have now the possibility of investing abroad and also going to the stock market, we can justify a higher management fees. So this is an another direction that we our plan to move on and then flip side also to change the culture, of course that we have many opportunities provided by the regulator like investing abroad of nation, investing in taxes also in credit securities. But we also dependent on the risk appetite of declines through (inaudible) uncertainties, it's going to be a (inaudible) different scenario that we can even see that details it's going to be a un-experience for the industry this year, we had it in 2013 when (inaudible) now to 7%, -- we are very short period of time if year-to make comparison, the average management fee in the market is around, something around 1.2% and we want to go back 13 years or even 15 years ago was twice as higher than one that we I think the market right now. So this is going to be a completely different environment. We will try to start changing all our investment profile and after allocation trying to also change their investment that savings culture of the Brazilian population for not an easy job. You need to (inaudible) industry will change a lot in the next years.

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A - Werner Suffert {BIO 18657101 <GO>}

So regarding the performance SH2 and combined ratio greater that region reached in 2016. I think it's worth noting that the loss ratio for the industry as a whole increases a lot this year and we have the impact of this new all fit reducing year-over-year. And we must back to numbers from 2008. So new cars, the new cars in the market are the thing that we had in 2008. And this of course impacted a lot that we choose. But we have some initiatives in place we are reprising our auto portfolio in the region where we have world competition, then comparing with the Southeast where the competition is higher. So this is a way that we are facing this issue.

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Of course, we have some months until the strategy try to have an impact in the portfolio as a whole. But it's the one thing. The other thing is trying to have more premiums from the bank insurance side of SH2, where the margins are higher and be more selective in the independent brokers side where we have more competition and we are facing, I would say, the loss ratio is higher with a very high acquisition cost. And even with reducing G&A ratio, we reached this very high combined ratio in 2016.

So that's how we are facing this year for 2017. We believe that the margins will be a little bit better than in 2016. But the First Quarter results -- the first and Second Quarter, we still are very cautious about the performance in SH2 because of the competition that remains very, very high and that our strategy regarding the pricing of the order portfolio is due in place. But to have this full impact, we will need some months to reach the full potential of the strategy.

So First Quarter, we will still have numbers that will be below our long-term combined ratio for SH2.

Operator

(inaudible).

Q - Unidentified Participant

Two questions on my end. The first one is actually a follow-up. You said that competition remains tough in the auto segment. Just wanted to understand if it's getting worse or if it is improving? It would be expected that was high (inaudible) and the decline in interest rates, players would get more rational. So just wanted to understand if this competitive environment is improving or not?

Second question is regarding the impairment of SH2. Just wanted to understand if it affects in any way your capital position or the Company's ability to distribute dividends? I guess not, just wanted to hear confirmation from you. Thank you.

A - Werner Suffert {BIO 18657101 <GO>}

Hi, Werner speaking, I will start with the second question. And after that we will move to the first one regarding SH2 and auto insurance. But the impairment that we had this quarter, the impact in our ability to pay dividend is zero. We will remain at paying the same level of (inaudible) that we have. And as I explained in the Portuguese earnings call, we have some -- we are serving and looking these numbers to see if we are even -- if we have some room to increase using the long term. But our goal is to remain at least at 80% in this adjusted net income view. But trying to move to a higher number as soon as possible and as soon as we have -- we will be able to sustain the same level, the new level of payout.

And moving to the SH2 questions regarding auto insurance, we believe that the competition will remain very tough in the First Quarters. But when you look the competition all across the country, we have different levels of competition. So the margins

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are higher in some regions like the Northeast and the North on Brazil and the Middle-east also but comparing with the South and Southeast. So we are very positive that we will be able to reprise our portfolio in these regions where the competition is lower. And we started the strategy last year. So we will start to have the impact of it in 2017.

But when you look the market, the auto insurance players in these regions, in the Southeast, in the South of Brazil, the competitions will remains very high here. And in these regions, we believe the repricing is bit tougher. And dividend broker portfolio would be very difficult to do this in the beginning of the year. So we have room to do this in the bancassurance side. And will try to move as soon as possible to move this strategy to the whole portfolio as soon as possible. But for the independent brokers, we believe that would be medium term this will be obviously, a medium-term strategy that would take place during the year of 2017, maybe in the end of the Second Quarter on.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I'd 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 for joining our conference call for the Fourth Quarter 2016. I need to (inaudible) that when we look at the current scenario for 2017, it's still in the transition period. We are going to face first-scenario core financial results. But when we exceed level of interest rates maybe reaching single digit, (inaudible) patient on the controlled digits with perfect environment for developing the insurance industry in the country.

So we are seeing this scenario to be very positive for the future, despite the negative impact that affect the short-term results. But when we look at the single-digit it's going to be a very good scenario for having knowledge insurance industry in the country. So thank you all once again 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. Have a nice day, you may now disconnect.

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