

Q1 2019 Earnings Call

Company Participants

- Rafael Sperendio, Head of Finance and Investor Relations
- Werner Romera Suffert, Chief Financial Officer

Other Participants

- Thiago Bovolenta Batista, Analyst

Presentation

Operator

Good morning, everyone, and thank you for waiting. Welcome to BB Seguridade's First Quarter 2019 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.

(Operator Instructions)

The presentation is available in the Financial Information Presentation section of BB Seguridade's RI website at www.bbseguridaderi.com.br/en.

Before proceeding, let me mention that forward-looking statements that may be made during this conference call regarding expectations, growth estimates, projections and future strategies of BB Seguridade are based on the 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 involved 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>}

Thank you. Good morning, everyone, and thank you for joining our first quarter earnings call. I'm going to take you through the presentation.

So let's start on page number 2 with the main highlights of the quarter. Our net income reached BRL1 billion in Q1, up almost 12% year-on-year. As you can see, on the chart on

the lower right-hand -- lower left-hand side here, the increase in the net income was driven by the robust performance of financial results, while the operational results remained almost flat year-on-year.

The BRL1 billion that we delivered in Q1 is equivalent to the return on average equity of 59% annualized. It's worth reminding that due to the first quarter that we are reporting with the full effect of the restructuring of the partnership with MAPFRE that freed up almost BRL2.7 billion paid as an extraordinary dividend early this year. So this was the main driver for this increase in the return on equity and besides the growth in net income.

Regarding the commercial performance, on a pro forma basis, that is replicating the effects of the restructuring that we end up in 2018, for the full year of 2018. Insurance premiums grew 17.5% with credit life spending now by growing 82% year-on-year. Term life also posted a very strong performance, up 9% year-on-year.

In our pension business, the main highlight came from the financial results helped by very favorable dynamics of the inflation index on the final benefit portfolio. The pension rate reached its all-time low. In this ratio, we do not consider the net transfers, it's just pure redemption.

Assets under management were up 9% over the last 12 months and reached BRL263 billion by the end of March.

In premium bonds, inflows grew 6.2% and the broker commissions increased 9.3%, given the solid commercial performance across the different businesses, as I just mentioned.

Moving forward on page number 3, we have the main drivers of the net investment income, financial results. On the negative side, we had a lower average Selic rate as compared to the same period last year. Also a negative impact coming from the dynamics of the forward yield curve. As you may see on the upper right-hand side, the yield curve moved down less than in the same period a year ago, which implies a lower mark-to-market gains in this quarter.

But on a positive side, we had at Brasilseg, our insurance operations, the disposal of some securities that were classified as available for sale, which added roughly BRL43 million to the financial results before taxes at insurance company. And also we saw very favorable dynamics, as I mentioned, of the inflation index, says that it helped a lot, financial results coming from the defined benefit pension plan at Brasilprev. It's worth reminding that most part of the liabilities of the defined benefit pension plans are pegged to the IGP-M and the cost of the liability is calculated with a one month lag on average, while the assets are composed of securities pegged to both IGP-M and IPCA with a slightly higher share of IGP-M coupons. And the yield in this case is calculated using the current inflation index.

As you can see on the lower left-hand side, financial expenses were favored by the deflation posted by the IGP-M in the fourth quarter last year, while the yield on the assets, it was helped by the inflation posted by both indexes in Q1.

So this is somewhat a reversing the losses that we provided in Q4, as we anticipated in our last earnings call. It's now helping Q1 financial results of Brasilprev. And the final outcome here, the combined financial results were up 61% year-on-year and accounted for 29% of the net income, the level that we clearly think that is not sustainable going forward, but we believe that financial results will lose this steam to operating results throughout the year. This is somewhat the expected dynamics going forward.

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On page number 5, we have the performance of our insurance business, Brasilseg. Just a brief disclaimer before diving into the numbers here, it's worth noting that within the restructuring of the partnership with MAPFRE, price being very exposed in terms of cost of services. It was net negative in terms of premiums as the company we divested that were bigger in premiums than the one that was incorporated. So just to look on the apples-to-apples comparison here, it's better to look at the pro forma figures. So premiums written grew 15.4% year-on-year driven mainly by term life and solid commercial performance of the credit life, which was up 82% driven mainly by individuals.

On Page 5, we have the key operating metrics of the insurance business. Combined ratio here was affected by the higher loss ratio, given the El Nino's effect that affected mostly the crop insurance. And G&A ratio rose 2.7 percentage points due to higher contributions to the rural insurance stability fund, which takes into consideration the operating results of the crop insurance on a cash basis. So that's why the contribution to the fund, they were not affected by the increase in the frequency of claims as of now because they were just for accounting purposes, they haven't appeared on cash basis yet. So we can expect that these expenses will normalize going forward, and we will come out at a lower level as compared to the first quarter.

Another effect that impacted the combined ratio was the increase in G&A ratio, as I mentioned. But now more concentrated on work that the insurance company has been done related to the revision of the provision of losses related to civil contingencies and also the regularization of some of the transitory accounts of the future deposits. I believe that this work is going to be down until the end of the semester, but impacted somewhat the Q1 figures, but it's going to normalize over the next quarters.

Moving to page number 6. We have the financial results of the business, up 129% driven mostly by the disposable securities that were previously classified as available for sale. But this very strong performance in financial results were not enough to offset the weaker performance in terms of combined ratio, that's why earnings coming at flat compared to the first quarter last year, mostly because of the El Nino effect and the impact in G&A that I explained before.

On page number 7, going to the -- now to discuss the performance of our pension business. Total deposits rose 6.2% year-on-year, while assets under management grew 9% over the last 12 months, with management fees growing slightly less as compared to the base posted by results, given the reduction on the average management fee charged that has been decreasing 1 bp per quarter, as expected, nothing different from the previous period.

And finally, in terms of net income comparison, it was up 45% as compared to a year ago, and helped by the solid performance of financial results, as I just explained.

Moving to premium bonds, collections were up 6% year-on-year driven mostly by the single payment bonds, while net income dropped 34% year-on-year given the contraction in the net interest margin, as you can see on the lower left-hand side. And the (inaudible) they are pretty much straight forward, the lower average Selic rate and lower mark-to-market gains as discussed in the analysis of financial results. Besides also the lower reinvestment yield that we have been seeing in terms when we are investing the proceeds of the Company.

Moving to page number 9. The broker commissions were up 9% year-on-year driven by very strong performance across different businesses, but mainly in pension that added roughly 30,000 new pension accounts, periodic plans that -- they have a very big contribution to commissions, and besides there is very strong performance in insurance mainly in credit life.

But besides, commissions increasing 9%, net income grew slightly less, 6%, and the main reasons for growing that was related to the decline in the EBIT margin that fell 200 bps year-on-year, and the main reason was the increase in the number of items sold. So as we pay Banco do Brasil, we reimburse them the costs on a cash basis. Every time we have an increase in the number of products sold, we have a compression in the EBIT margin. So this is pretty much straightforward. Going forward, we don't think that it's going to repeat -- it's going to normalize as we have been shifting our focus towards products with a higher tickets or more close to the average from second quarter on.

And to wrap up the presentation, on page number 10, we have our guidance monitor. So in the first quarter, we outperformed in two indicators, the adjusted net income and premium growth at Brasilseg.

We believe that it's too early to make any kind of revision now and the factors that led us to overcome our earnings guidance specifically, it was related to the performance of financial results, which we don't believe that will be repeated throughout the year. And in terms of our outperformance of premiums written, we will observe this credit life specifically, which was the main driver for this outperformance. Credit life will be able to maintain such a strong performance when it starts to create hard comps from now on. So we are still cautious. And now we believe that both indicators, they will converge to the guided range over the next quarters.

So that's all. We can now jump into the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session.

(Operator Instructions)

Our first question comes from Thiago Batista with Itau BBA.

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

Hi guys. Good morning. The first question I have is about the loss ratio in the agri business segment. For sure, we saw a big increase in the loss ratio and for sure that will not continue for a long period of time. But is it really possible to see some normalization or some decline in this loss ratio in agri business already in the second Q? Or this is more a movement that we should expect for the second half of the year?

My second question, if you can give a little bit of more color about the net inflows in the pension business. We saw a material reduction in this net inflow in the first Q. So if you can give a little bit of more color of the trends you are seeing in the inflows in the pension business.

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

Thank you, Thiago, for your questions. Werner, I will answer your first one and Rafael will answer the second one. So the crop insurance loss ratio, it was in the very high level during the first quarter due to El Nino effect. And we believe that this loss ratio will start to drop from the second quarter on. And this will, of course, be higher than other crop cycles because it started in a higher level, but will be much lower than the numbers, I would say, annualized numbers from the first quarter. So it will reduce throughout the year and -- but will be in higher levels than the ones that we had in 2018. Okay?

A - Rafael Sperendio {BIO 18963159 <GO>}

Regarding the pension business, Thiago, we saw a drop of roughly 50% in terms of net inflows. Of course, there is some impact from competition, but (inaudible) our Q1 figures. We -- within the distribution network at Banco do Brasil, they had a big focus on periodic plans that it's clearly a portfolio that has a lower ticket as compared to the average. So it was -- it managed in terms of inflow as well.

If we were to compare, total inflows grew 6% year-on-year for Brasilprev. But if we were to look at how much Brasilprev contributed to commissions at the broker, the growth of commissions arising from the sales of the Brasilprev products increased 17%, so almost three times.

This clearly shows the strategy of the focus on this periodic plans. In terms of number of active pension plans in Company, we saw a jump of 30,000 new plans added in the first quarter this year. So because of this lower ticket, we saw an impact in total inflows. That's why net inflows declined by almost 50%. We kept this focus until March, mid-February, beginning of March. And from April 1, we are moving our focus towards the sporadic plans now in the second quarter where they have much higher tickets. We believe that the net inflows will normalize from now on. So this was more or less the dynamics that have occurred in the first quarter. I'm not sure if I was clear enough. But the main thing is, in summary, the focus on periodic plans that have lower tickets.

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

Okay. Very clear, Rafael. Thanks, Werner.

Operator

(Operator Instructions)

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

A - Rafael Sperendio {BIO 18963159 <GO>}

I'd like to thank you, everyone, once again, for joining our earnings call. Our Investor Relations team is available for any further questions that you might have. And 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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